



## OTHER FISCAL ISSUES

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### INTRODUCTION

This section discusses several fiscal issues not directly related to the executive budget, but that will potentially have an impact on the budget passed by the legislature and/or the budget process. The purpose of this section is to provide legislators with an overview of each of these issues. The issues discussed in this section are listed below and are discussed in more detail in the pages that follow.

- **K-12 Lawsuit Issue.** Actions of the 59<sup>th</sup> Legislature in some ways addressed the issues raised by the court decision, but the plaintiff, the Montana Quality Education Coalition, still contends that the state is not meeting its funding obligations and has contracted for another study. In the meantime, the executive's proposed increase in K-12 general fund spending is \$140 million, a 12 percent increase over the 2007 biennium.
- **Other Litigation Issues.**
  - *State Fund.* Three lawsuits related to workers' compensation claims could cost the general fund between \$99 and \$124 million.
  - *Navigable Waterways.* The owners of hydroelectric dams located upon the navigable stretches of Montana rivers filed suit seeking, in part, a judgment that the dam owners need not make any lease payment to the state. While no official settlement estimate exists, the backlog is valued at over \$100 million and the annual income is potentially \$5.0 to \$6.0 million.
  - *PPL Protested Taxes.* The total amount of state property tax protested by PPL between 2000 and 2005 is \$7.9 million. The local share in the same period was \$24.0 million.
- **Tobacco Settlement Funds.** The state expects to receive \$71.4 million in the 2009 biennium, at least 40 percent of which will be deposited into a trust. Another 49 percent was earmarked for specific purposes. The general fund receives 11 percent.
- **Wildfire Funding/Declining Federal Support.** Montana does not appropriate funds for future fire costs, and therefore, each legislative session the legislature is asked to provide a supplemental appropriation to pay for all state costs of fighting fires in the current biennium. In two of the past four fire seasons, state costs have been \$35.0 million and \$37.7 million. There are two issues: 1) the cost of suppression operations has increased, and 2) federal participation is declining.
- **State Fund "Old Fund" Liability.** Besides the potential costs of the lawsuits mentioned above, the general fund is on the hook for other "old fund" liabilities that are expected to be general fund obligations by the 2015 biennium.
- **Long-Term Stability of General Fund.** Since the general fund is critical to the operations of state government, the long-term stability of this account is an issue that must be examined for development of sound fiscal policies.
  - *Revenue Stability* - The downturn in revenues during FY 2002/2003 illustrates the sensitivity of Montana's revenue stream to world events and investment opportunities.

- Economic upturns or downturns are rarely accurately projected nor can disasters or world developments be anticipated.
- *Reliance on Federal Funds* - With federal deficits and the continued Iraq war funding demands, the prospect for federal funding freezes or reductions is a real possibility, not only in the near-term but also in the long-term.
- *Funding Demands* - In addition to the current trends of growing caseloads and inflationary pressures, an aging population and future growth in school enrollment figures provide a foreshadow of dramatic increases in demand for state funded services.
- **Statutory Appropriations.** Expenditures from statutory appropriations in the 2009 biennium are estimated at nearly \$300 million, of which \$181 million is for entitlement payments to local government.
- **General Fund Transfers.** Transfers from the general fund to other funds in the 2009 biennium are estimated to be \$18.4 million.
- **Fund Balance Adequacy/Reserves.** With the experiences of the 2001-2002 revenue shortfall still fresh, the legislature will need to determine what amount of ending fund balance is sufficient to ensure budget stability, particularly with the uncertainties of Montana's revenue stream.
- **Other Major Funds.**
  - *Highway Special Revenue Account.* The executive budget presents a balanced budget from the account, but when considering initiatives to expand the use of state funds for highways, the legislature may want to consider the impacts high construction cost inflation and the impacts decreased federal aid would have on the state highway program.
  - *Resource Indemnity Account (RIT).* Three of the nine funds in the executive request to spend RIT allocations or interest earnings, are projected to have negative balances by the end of the 2009 biennium. An interim study by a subcommittee of the Legislative Finance Committee (HJR 36) resulted in recommendations that the 2007 Legislature will consider.

## K-12 LAWSUIT ISSUE

### LITIGATION: K-12 FUNDING ADEQUACY

On April 15<sup>th</sup>, 2004, the Montana First Judicial District Court under Judge Sherlock found the Montana system of funding K-12 education unconstitutional. The Sherlock decision found that the state share of school spending was inadequate, and the current funding formula was not rationally related to educationally relevant factors. In addition, the Sherlock decision found the State has failed to recognize the distinct and unique cultural heritage of American Indians and has shown no commitment in its educational goals to the preservation of their cultural identity.

In March 2005, The Supreme Court issued an opinion affirming the District Court in all its findings. The Court ruled that in order to construct a basic system of free quality public schools, the legislature must define what constitutes quality and create a funding formula correlated to that definition.

In response to the Supreme Court's decision, the legislature made substantial changes to Montana's school funding laws during the 2005 regular and special sessions. In the 2005 regular session the legislature enacted SB 152, which among other things defined a basic system of free quality public schools. SB 152 also required the legislature to develop a mechanism to fund the basic system and required that such a formula be enacted by July 1, 2007. In addition, the legislature appropriated an additional \$91.4 million for K-12 and Office of Public Instruction (OPI) for more Base Aid and for Indian Education for All, among other increases. The percent increase above FY 2004 levels of Base Aid was 7.2 percent in FY 2006 and 8.0 percent in FY 2007.

In the 2005 regular session, the legislature also enacted SB 525, which created the Quality Schools Interim Committee (QSIC). The committee was directed to assess and study the costs of providing a basic system of quality public schools and provide the legislature with recommendations on the construction of a new funding formula. The QSIC developed a new funding formula based on five new components in the district general fund: a per-student component, an accredited programs component, a classroom component, an operation and maintenance component and a special education component. These components were based on known expenditure data for FY 2004. The entire cost of the proposals was an additional \$241 million in state and local funds for K-12 per year.

The December 2005 special session, building in part on some of the work of QSIC, created four new on-going Base Aid components: a quality educator component, a close the American Indian achievement gap component, an at risk component, and an Indian Education for All component. These components increased on-going state aid in FY 2007 by \$35.9 million. In addition the legislature provided one-time funding of \$32.0 million for Indian Education for All, operation and maintenance, and energy cost relief. An additional \$2.5 million was appropriated for a K-12 facility condition study.

In June 2006, the plaintiffs in the original case, the Montana Quality Education Coalition (MQEC), filed a motion with the district court requesting that Judge Sherlock schedule a show cause hearing at the conclusion of the 2007 session to ascertain if the state has met its obligations under Sherlock's district court finding on inadequacy in state funding for K-12. The Attorney General urged Judge Sherlock to reject this request because the two intervening legislative sessions made the issue moot. Judge Sherlock, in August 2006, ruled that it was premature to schedule a show cause hearing until after the 2007 legislative session. Sherlock invited the plaintiffs to re-apply after the 2007 session. In the meantime, MQEC has hired consultants to assess the costs of a quality system of free public schools

using the professional judgment and successful schools methodology. The results of these studies will be available for the 2007 session.

## **DID LEGISLATIVE ACTION ADDRESS COURT REQUIREMENTS?**

The Sherlock decision ruled that the current K-12 funding formula (containing a basic entitlement and a per ANB, a measure of child count entitlement) was unconstitutional because: 1) it was based on spending data two years old at its implementation; 2) the entitlement amounts were not based on educationally relevant factors; 3) it relies too much on ANB; and 4) it contains no inflation factor. The 59th legislature's actions did not change the components of the current formula but instead augmented the current formula by adding four new components paid for with state money. This, in part, mitigates item 1 above by adding money that in partially makes up for past inflationary shortfalls. In addition, the passage of SB 152, which defines a basic system of quality education, addresses issue 2 above. In spite of the failure of the QSIC to pass a new funding formula, the new components developed during the special session were devised to be defensible in court because they address a portion of the definitions of a basic system of quality education in SB 152. Also, the legislature in the 2003 session added provisions to inflate the entitlements starting in FY 2006 and continuing in future biennia. Also, in the 2005 legislative session, the legislature adopted three-year averaging of ANB, which attempts to address the problem of declining enrollment. The creation of an educator component will further add to funding stability. Finally the legislature, in creating new components that target at-risk and American Indian students, has directed funds to those districts challenged with low achievement.

The full resolution of how to define a basic system of quality education and how to fund it will likely remain a point of contention for a long period of time, as it has been in most other states. Future increases in K-12 funding are likely to be large by historical standards.

## **EXECUTIVE RECOMMENDATION – 2009 BIENNIUM**

The executive makes no reference as to whether the executive budget recommendations for K-12 satisfy the requirements of the district court. The executive recommends a budget for K-12 that is "in keeping with 1972 Montana Constitution". The executive proposes funding for full day kindergarten, continuation of funding for the four new components that were created in the December 2005 Special Session, an increase in the per educator payment, state funding of retirement costs for school employees paid with federal money, inflation for the entitlements and special education, diversion of royalty income on state lands into a school facility trust fund, continuation of the student data information system, six new curriculum specialists and more money for Indian Education for All. The recommended increase in K-12 general fund spending is \$140 million, a 12 percent increase over the 2007 biennium. For further information, see the summary on page 110 of this volume and the Office of Public Instruction budget narrative beginning on page E-1 of Volume 7.

## OTHER LITIGATION ISSUES

### STATE FUND LAWSUITS

Three lawsuits related to workers' compensation claims could cost the general fund between \$99 and \$124 million.

The Montana State Fund provides Montana employers with an option for workers' compensation and occupational disease insurance. Prior to 1990, workers' compensation experienced significant liabilities. The legislature separated state fund liabilities between claims occurring before July 1, 1990 and claims occurring on or after that date. Funds relating to claims prior to July 1, 1990 are referred to as "Old Fund" and those on or after as "New Fund". Statutes require that in any fiscal year claims for injuries from accidents occurring before July 1, 1990 are not adequately funded, the funds must be transferred from the general fund. As of June 30, 2006 the estimated Old Fund liabilities exceeded assets by \$21.9 million. At this time, the Old Fund has sufficient invested assets to meet its obligations until the year 2013. At that time general fund may need to offset this shortfall.

Three court cases brought against the Montana State Fund (MSF) may increase the shortfall in the Old Fund by up to \$124 million.

- *Stavenjord* was decided by the Montana Supreme Court in regard to retroactivity and common fund status in October of 2006. This case relates to the failure of the Occupational Disease Act to provide the same permanent partial disability benefits for occupational diseases as provided for injuries. The court held retroactivity to July 1987 but did not grant common fund status. Instead the court required application to those claims which remain open. Previously settled claims are not included in the decision. The Montana State Fund previously estimated the potential benefit costs to be between \$5 and \$7 million to the Old Fund if common status was applied to retroactive claims. MSF is re-estimating the cost of the decision on Old Fund claims, which will be reduced as settled claims were included in the prior estimate.
- *Reesor*, the Montana Supreme Court determined that the practice of denying permanent partial disability benefits to persons who are receiving social security benefits or are eligible for full social security retirements benefits violates the Equal Protection Clause of the Montana Constitution. The case is pending on decision of the Workers' Compensation Court regarding establishment of a common fund and retroactivity. Montana State Fund staff estimate a potential estimated benefit cost increase of \$1 million to the Old Fund if the decision is held to apply retroactively.
- *Satterlee* challenges the constitutionality of terminating permanent total disability and rehabilitation benefits when a claimant receives or becomes eligible to receive full Social Security retirement benefits or an alternative to that plan. A Montana Workers' Compensation Court judge ruled in favor of the respondents/insurers (including Montana State Fund) in December 2005. A request for reconsideration of the case was denied by the Montana Workers' Compensation Court. The case has been appealed by the plaintiffs to the Montana Supreme Court. A decision by the court could be expected in mid to late 2007, after the end of the 2007 session but prior to the beginning of the 2009 biennium. The potential estimated benefit costs for non-settled permanent total disability claims, if the statute is ultimately held to be unconstitutional and to apply retroactively, is between \$93 and \$116 million for the Old Fund.

## **NAVIGABLE WATERWAYS**

The state owns the beds of navigable waters from low-water mark to low-water mark for the benefit of the common schools. The Department of Natural Resources and Conservation is charged with managing these lands, including assuring an annual lease payment agreement exists. PPL Montana, PacifiCorp, and Avista are owners of hydroelectric dams located upon the navigable stretches of Montana Rivers. These entities filed suit in Montana First Judicial District Court seeking, in part, a declaratory judgment that, pursuant to the Federal Energy Regulatory Commission (FERC) license held by the respective parties, the dam owners need not make any lease payment to the state. In April of 2006, Judge Honzel ruled that the dam owners were obligated to enter into leases, as the Federal Power Act (and subsequent FERC license) did not preempt the provisions of Montana law, and the statute of limitations did not apply to limit recover of past damages.

The dam owners and the state are in a negotiated settlement process for past damages and the establishment of a reasonable lease rate. If a settlement is not reached, there remains the possibility of the case being heard in front of the Supreme Court. While no official settlement estimate exists, the backlog is valued at over \$100 million and the annual income is potentially \$5.0 to \$6.0 million.

## PPL PROTESTED PROPERTY TAXES

PPL Montana (PPL), a subsidiary of Pennsylvania Power and Light (PPL), has protested a portion of its property taxes every year since tax year 2000. Before passage of SB 294 in the 2003 session, these taxes were paid into an escrow account and were unavailable for use by the state, local governments and schools. SB 294 authorized the state share of these taxes to be deposited in the state general fund. In the 2005 session, this distribution was changed by SB 87 which directed that half the protested taxes be deposited in a state special account and the other half in the general fund. The state special account monies would be used to pay protested tax amounts in the event the state loses a case.

PPL appealed to the State Tax Appeal Board (STAB), contending: 1) the Department of Revenue (DOR) improperly centrally assessed the property; 2) the DOR improperly included tax exempt intangible personal property; 3) the DOR improperly valued the pollution control property at its Colstrip units; and 4) the valuation of their properties was unconstitutional because when its valuations are compared to valuations of like property owned by other generation utilities in the state, PPL properties were valued considerably higher. The PPL appeal for tax years 2000 through 2002 was decided February 11, 2005 by STAB which ruled in favor of the state for tax years 2000 through 2002 regarding whether the property should be centrally assessed and on whether the DOR properly calculated exempt intangible personal property. STAB also adjusted PPL valuations for 2000-2002 in a manner that DOR did not agree with. STAB did not rule on the purely legal issues involving PPL's constitutional claim. PPL has protested and appealed its assessments for tax years 2003 through 2005, but the parties have agreed to hold in abeyance any proceedings regarding these years until a final determination of the case for tax years 2000 through 2002 has been made.

An appeal was heard in Judge Sandefur's district court in Great Falls and a decision was rendered on April 28, 2006. Judge Sandefur ruled for the state and the constitutional claims of PPL were rejected. However, the district court ruled the new valuation methodology employed by STAB was correct.

PPL appealed this decision to the Montana Supreme Court and the case will likely be decided sometime in 2007. The DOR has applied for and was granted an expedited appeal. The state has cross appealed to reject the new valuation methodology employed by STAB.

The total amount of state property tax protested by PPL between 2000 and 2005 is \$7.9 million. This amount has not been adjusted for settlements made between the department and PPL. The local share in the same period was \$24.0 million.

The Northwestern protest was for tax year 2005. Northwestern claims that increases in its valuation above 2004 levels are incorrect. The taxable value being protested is approximately \$21.9 million. The case will be heard by STAB February 5<sup>th</sup> through the 7<sup>th</sup> in Helena.

There were other centrally assessed companies protesting property taxes in tax year 2005. The total taxable value of these protests is \$16.3 million and includes Qwest, Puget Sound Energy, Omimex, Pacificorp, and Encana.

## TOBACCO SETTLEMENT FUNDS

Montana receives revenue as a settling party to a master settlement agreement (MSA) with four original tobacco companies and 46 subsequent companies that ended a four-year legal battle that included 46 states and 6 other entities. Currently, Montana is eligible for two types of payment: 1) on-going annual payments (to be received April 15th); and 2) strategic contribution payments (from FY 2008 through FY 2017). The MSA places no restrictions on how states are to spend the money.

### REVENUE

The total amount of tobacco settlement funds available to Montana may be affected by a number of adjustments. The three most important are the adjustments for inflation, volume of cigarettes shipped nationally, and participating manufacturers' (PM) loss of market share. Montana's annual share will increase by a minimum amount of 3 percent or more if inflation is greater than 3 percent. The amount will decrease if the number of cigarettes shipped nationally decreases and will increase if the number increases. Proceeds may be reduced if it is proven that PM have lost market shares to those manufacturers who do not participate in the agreement and that the loss was significantly due to disadvantages caused by the MSA. This adjustment does not apply to a state that had a "qualifying statute" in effect for the full year in question and had diligently enforced it. Although PM have lost market shares, there is disagreement over the "qualifying statute" condition. The revenue estimates shown in the table below include the market share loss reductions; not because all the conditions have been met, but because the PM may dispute a portion of a payment. The result is a portion of the money becomes unavailable to the settling entities even though the adjustments were not officially applied to the payments.

The table below shows the revenue Montana has received through FY 2006 and amounts expected in FY 2007 and the 2009 biennium, as contained in HJ 2. The increase in revenue, due to larger payments by tobacco companies and the start of the strategic contribution payments, masks the reduction caused by the anticipation that PM will withhold a portion of their payments in FY 2007 and the 2009 biennium until the cause of the loss of market share is proven.

| Figure 1<br>Tobacco Settlement and Tobacco Trust<br>Revenues and Distributions |               |               |                       |              |               |   |               |              |
|--|---------------|---------------|-----------------------|--------------|---------------|---|---------------|--------------|
| Tobacco Settlement Revenue Allocations   |               |               |                       |              |               | Tobacco Trust Interest Earnings Allocations |               |              |
| Current<br>Distribution %  | 11%           | 40%           | State Special Revenue |              | 100%          | 90%   | 10%           | 100%         |
| Fiscal Year  | General Fund  | Trust Fund    | Treat/Prevention      | CHIPS, CHA   | Total         | State Special                               | Tobacco Trust | Total        |
| 2000 Actual  | \$34,804,411  | \$0           | \$0                   | \$0          | \$34,804,411  | \$0   | \$0           | \$0          |
| 2001 Actual*   | 15,989,101    | 10,650,750    | 0                     | 0            | 26,639,851    | 98,519                                      | 71,172        | 169,691      |
| 2002 Actual  | 18,647,411    | 12,431,607    | 0                     | 0            | 31,079,018    | 1,015,407                                   | 22,212        | 1,037,619    |
| 2003 Actual  | 18,699,611    | 12,466,407    | 0                     | 0            | 31,166,018    | 1,647,194                                   | 160,832       | 1,808,027    |
| 2004 Actual**  | 2,933,928     | 10,668,829    | 8,535,064             | 4,534,252    | 26,672,073    | 2,402,846                                   | 266,983       | 2,669,829    |
| 2005 Actual  | 2,977,777     | 10,828,281    | 8,662,625             | 4,602,020    | 27,070,703    | 2,882,103                                   | 320,234       | 3,202,336    |
| 2006 Actual  | 2,733,614     | 9,940,413     | 7,952,330             | 4,224,676    | 24,851,033    | 3,048,774                                   | 338,753       | 3,387,527    |
| 2007 Estimate  | 2,821,940     | 10,261,600    | 8,209,280             | 4,361,180    | 25,654,000    | 3,545,100                                   | 393,900       | 3,939,000    |
| 2008 Estimate  | 3,855,390     | 14,019,600    | 11,215,680            | 5,958,330    | 35,049,000    | 4,110,300                                   | 456,700       | 4,567,000    |
| 2009 Estimate  | 3,995,530     | 14,529,200    | 11,623,360            | 6,174,910    | 36,323,000    | 4,871,700                                   | 541,300       | 5,413,000    |
| Totals   | \$107,458,713 | \$105,796,688 | \$56,198,339          | \$29,855,368 | \$299,309,108 | \$23,621,942                                | \$2,572,086   | \$26,194,028 |

\* In addition, \$1,143 general fund was recorded as prior year revenue.

\*\* In addition, \$22,189 of interest to the trust was recorded as prior year revenue.



## DISTRIBUTION

In FY 2000, the revenue received from the MSA was deposited to the general fund. However, due to passage of Montana Constitutional Amendment 35 by the electorate in November 2000, beginning in January 2001, the legislature is required to dedicate not less than 40 percent of tobacco settlement money to a permanent tobacco trust fund. Since the legislature has not yet specified in statute the exact percentage to be distributed to the tobacco trust fund, the revenue estimates assume 40 percent. From July 2000 to June 2003, 60 percent of the money was deposited into the general fund. Due to passage of Initiative 146 by the electorate in November 2002, beginning July 2003, 32 percent of the total tobacco settlement money funds tobacco prevention/cessation programs and 17 percent of the total funds the Children's Health Insurance Program and programs of the Comprehensive Health Association (CHA). Senate Bill 485 (17-6-606, MCA) enacted by the 2003 Legislature allowed the 32 percent allocation to be used for human service programs and the 17 percent allocation to be used to match federal Medicaid money. These allowances terminated the end of June 2005. Money from both allocations can be used for tobacco disease prevention and to fund the Tobacco Prevention Advisory Board. Money not appropriated within two years is transferred to the tobacco trust fund. The remaining 11 percent of the MSA money is deposited to the general fund. Senate Bill 485 authorized the transfer of \$5,831,360 in FY 2004 and \$6,057,600 in FY 2005 from the account receiving the 32 percent allocation to a newly created prevention and stabilization state special revenue account. The table above also shows actual settlement amounts distributed to the general fund, tobacco trust fund, and state special revenue accounts through FY 2006 and the amounts estimated to be distributed in FY 2007-2009.

## TOBACCO SETTLEMENT TRUST FUND

As stipulated in the Montana Constitution, interest earnings from the tobacco settlement trust fund are to be distributed:

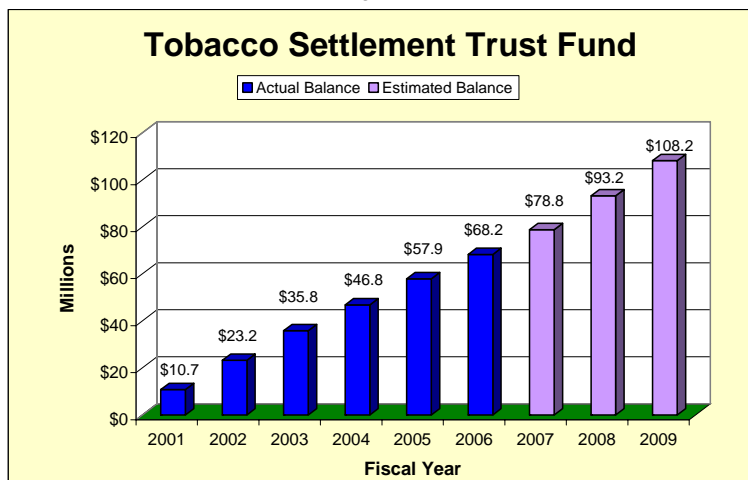
- 90 percent for appropriation by the legislature for disease prevention programs and state programs providing benefits, services, or coverage related to the health care needs of the people of Montana
- 10 percent to the tobacco trust

The table above shows these actual and estimated amounts.

The tobacco trust fund began receiving deposits of settlement proceeds and interest earnings

in FY 2001. Figure 2 shows the fiscal year end fund balances through FY 2006 and the balances estimated by the legislature for FY 2007 and the 2009 biennium. Money in the tobacco trust fund can be spent if approved by 2/3 of each house of the legislature. Appropriations of principal, income, or interest from the trust fund cannot be used to replace state or federal money that supports tobacco disease prevention programs that existed on December 31, 1999.

Figure 2



## WILDFIRE FUNDING/DECLINING FEDERAL SUPPORT

Montana does not appropriate funds for future fire costs. Instead, the cost incurred by state government are paid by the agencies (Department of Natural Resources and Conservation, and the Department of Military Affairs) as they become due, and the legislature then provides a supplemental appropriation to both to pay all outstanding claims and to reimburse the agency (s) for costs already paid. Therefore, each legislative session the legislature is asked to provide a supplemental appropriation to pay for all state costs of fighting fires in the current biennium.

### INCREASE IN AVERAGE COSTS

Expenditures during the 2007 biennium drastically increased the average annual cost of fire suppression. While FY 2006 was within the normal range, FY 2007 was an extreme fire season. Total costs for the biennium were over \$69.8 million, of which approximately \$43.7 million was the responsibility of the general fund. The Governor's emergency fund provided \$13.7 million in funding, resulting in the need for a supplemental appropriation of \$30 million. For a further discussion see the program narrative in the Department of Natural Resources and Conservation in Volume 5 of the Legislative Budget Analysis 2009 Biennium

Fire seasons of the 2007 biennium caused an increase in the average annual cost from \$7.0 million to \$13.3 million, as summarized in Figure 3. The LFD calculates the annual average by examining the costs of the last seven fire seasons and removing the high and low seasons and dividing by five. As shown in the table, the average cost to the state has doubled.

There are two issues behind increased fire costs. First, the cost of suppression operations has increased. A major driving factor of the increase is the cost of diesel, aviation and automobile fuel. The increase in this commodity between the last major fire season of FY 2004 to FY 2007 was approximately 100 percent. The second issue is declining federal participation.

| Figure 3<br>Figure<br>Average Cost of Fire Suppression |              |                |              |
|--|--------------|----------------|--------------|
| Fiscal Year  | Total Cost   | Reimbursements | Net Cost     |
| 2001   | \$54,925,104 | \$44,784,017   | \$10,141,087 |
| 2002   | 16,417,193   | 3,549,700      | 12,867,493   |
| 2003   | 6,710,688    | 4,684,927      | 2,025,761    |
| 2004   | 79,579,965   | 44,582,841     | 34,997,124   |
| 2005   | 3,969,096    | 989,945        | 2,979,151    |
| 2006   | 8,806,797    | 3,066,927      | 5,739,870    |
| 2007   | 61,000,318   | 23,290,928     | 37,709,390   |
| 7 year averages  | \$33,058,452 | \$17,849,898   | \$15,208,554 |
| 5 year adjusted average                                | \$29,572,020 | \$15,835,065   | \$13,344,945 |

### DECLINING FEDERAL ASSISTANCE - FEMA

Availability of federal assistance from the Federal Emergency Management Agency (FEMA) is declining. During the 2000 fire season (FY 2001), Montana was provided blanket approval for financial assistance from the head of FEMA when he toured the fires with Senator Max Baucus. In FY 2004, the state received assistance based on the established criteria wherein 50 structures were threatened. Beginning FY 2007, FEMA raised that threshold to 100 structures. This change is a result of FEMA standardizing threshold criteria across the nation. Given the changes, Montana qualified for FEMA assistance on only three fires in FY 2007, the Saunders, Emerald Hills and Derby, while other large fires such as Bundy Railroad and Jungle did not qualify.

## **FEDERAL AUDIT IMPLICATIONS – US FOREST SERVICE**

Another sign of decreased federal assistance is the recent issuance of an audit by the US Department of Agriculture, Office of Inspector General titled “Forest Service, Large Fire Suppression Costs”. This report provides three recommendations to the US Forest Service (USFS), including clarification of responsibility for fire protection of the wildland urban interface, increased use of wildland fire use tactics for resource objectives, and adoption of wildfire cost assessment reviews. While each could impact fire suppression in Montana, the greatest concern is the wildland urban interface issues.

This recommendation was made to encourage the USFS to obtain congressional clarification as to the responsibilities of the USFS and the states in protecting the expanding wildland urban interface developments and other private properties threatened by wildfires. The audit contends that the USFS has borne more than its share of costs in fire suppression for structures while losing valuable natural resources. The policy of the USFS is to evaluate protection of structures and natural resources on an equal basis.

The audit contends that the USFS is subject to an inequitable wildfire protection burden because the direct protection agreements with state or local governments have not been renegotiated to reflect appropriate wildland urban interface protection responsibilities. The audit claims the inequity is the result of inadequate planning of state and local government as the federal agencies do not have power to regulate development in the wildland urban interface. In addition, the belief is that if states become financially responsible for suppression in the wildland urban interface, it would likely encourage states and local governments to actively implement land use regulations that minimize the risk to property from wildland fire.

## **POTENTIAL IMPACT ON MONTANA**

As per the response from the USFS, they intend to seek the congressional clarification and, at the same time, begin a process to evaluate where renegotiation of direct protection agreements need to be completed. Montana’s agreements will most likely be reviewed. Under the current direct protection agreement, the Department of Natural Resources and Conservation has essentially traded protection of the area surrounding the community of Big Sky for less costly protection area around Dillon. Due to the fact that Big Sky is a wildland urban interface area, the state may be put in the position to assume direct protection of Big Sky. If so, the state will be responsible for initial attack and total suppression costs for the area.

Second to this potential change in direct protection negotiations, is the shift in cost sharing for on-the – ground responses. The current USFS agreement is based upon allowable costs. If the USFS adopts the philosophy of more wildland fire use and less suppression, the state may incur costs that are not allowable for cost sharing based on the type of suppression tactics used.

## SUMMARY

FEMA has already implemented measures that reduce the availability of assistance to states for wildland fire suppression. In addition, the USFS contends that they will implement recommendations of the audit. The implementation of those recommendations will come with an undetermined cost to the state. Between the known and unknown reductions in federal assistance and the overall increase in the costs to suppress fires, the cost to the general fund to cover wildland suppression costs will increase, resulting in increased requests for supplemental appropriations. To mitigate this increase and improve cash flow, the legislature may wish to consider the following options:

- o Request legislation to establish a statutory appropriation of general fund for the annual average cost of fires suppression
- o Include a line item appropriation of general fund in HB 2 for wildland fire suppression
- o Request legislation to increase the Governor's emergency fund from \$16.0 million to \$25 million
- o Request legislation to create a wildland fire revolving fund

The Legislative Finance Committee is sponsoring LC 545 to establish a wildland fire suppression fund. This legislation includes a one-time transfer of \$25.0 million to establish the new fund. The executive's budget request includes an additional deposit of \$5.0 million per year to the fund and each year thereafter.

The executive has requested LC 711 to increase the emergency fund from \$16.0 million to \$25.0 million. The proposed legislation does not eliminate the need for a disaster declaration to access the fund.

Additional information on each option is provided in Volume 5 in the Agency Issues section of the Department on Natural Resources and Conservation.

## STATE FUND "OLD FUND" LIABILITY

The Montana State Fund provides Montana employers with an option for workers' compensation and occupational disease insurance. Prior to 1990 workers' compensation experienced significant liabilities. The legislature restructured the state fund, and separated state fund liabilities between claims occurring before July 1, 1990 and claims occurring on or after that date. Funds relating to claims prior to July 1, 1990 are referred to as "Old Fund" and those on or after as "New Fund".

Statutes require that in any fiscal year where claims for injuries from accidents occurring before July 1, 1990 (Old Fund) are not adequately funded, the funds must be transferred from the general fund. As of June 30, 2006 the estimated liabilities exceeded assets by \$21.9 million. At this time, the Old Fund has sufficient invested assets to meet its obligations until the year 2013, when general fund may need to offset this shortfall.

It is important to note that three cases currently being resolved through the Worker's Compensation Court and the Montana Supreme Court may affect both the amount of the liability and how long the fund has sufficient assets to meet its obligations. These cases and the related potential liability amounts are discussed in "Other Litigations Issues", page 177 of Volume 1.

## LONG-TERM STABILITY OF GENERAL FUND

### INTRODUCTION

The state general fund is the primary account that funds a significant portion of the general operations of state government. Since this fund is critical to the operations of state government, the long-term stability of this account is an issue that must be examined for development of sound fiscal policies. This section of the document discusses three key issues relevant to the 2007 legislative session and the necessary planning for subsequent sessions. The issues addressed are: 1) revenue stability; 2) reliance on federal funds; and 3) funding demands.

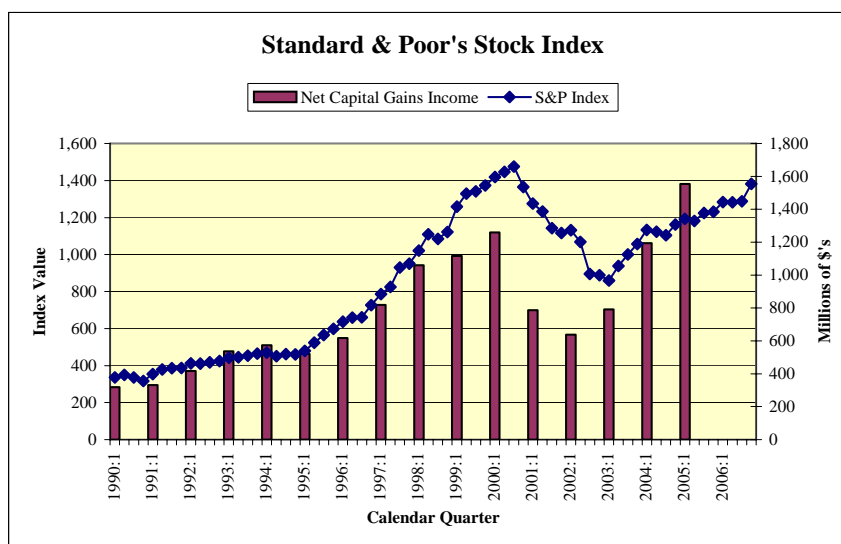
### REVENUE STABILITY

There are three major components of general fund revenues that have contributed to increased revenue collections in recent years: capital gains income, oil and gas price and production, and corporate profitability. Reliance on capital gains upswings is the “poster child” of over-reliance on sustained growth, and expanding government services based on unsound fiscal policy.

#### *Capital Gains*

The 1990's were generally good years for Montana's economy. With a few exceptions, Montana experienced above average employment and wage levels that translated into strong tax revenue growth. This revenue growth was further enhanced by the significant increase in the equity markets and the resulting growth in capital gains income. During calendar 2002 and 2003, however, the state's financial picture blurred as the effects of a national economic recession, terrorism threats, and mid-east tensions played havoc on the US economy. Although Montana's economic base remained relatively stable during this period, state general fund revenues plummeted. This inconsistency was due to the precipitous fall in equity markets, low interest rates, and reduced corporate profits. All of these factors contributed to the 2002/2003 budget crisis while the state's economy continued to outperform the national economy.

Figure 4



As Montana moves forward into the next century, there are valuable lessons that can be extracted from the financial experiences of the 1990's. For example, as the information technology age was exploding during the nineties, the equity markets were experiencing phenomenal growth rates. As shown in Figure 4, the S&P stock index reached a high of almost 1,500 in calendar 2000 and then declined abruptly until 2003 when the index dropped to about 850. Figure 4 also shows the corresponding trend in net capital

gains realizations as reported on Montana's tax returns. As the figure shows, the trends in reported net

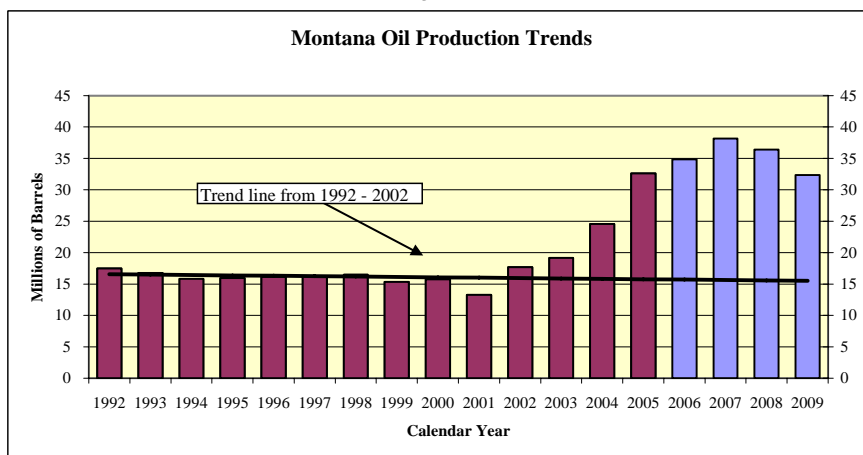
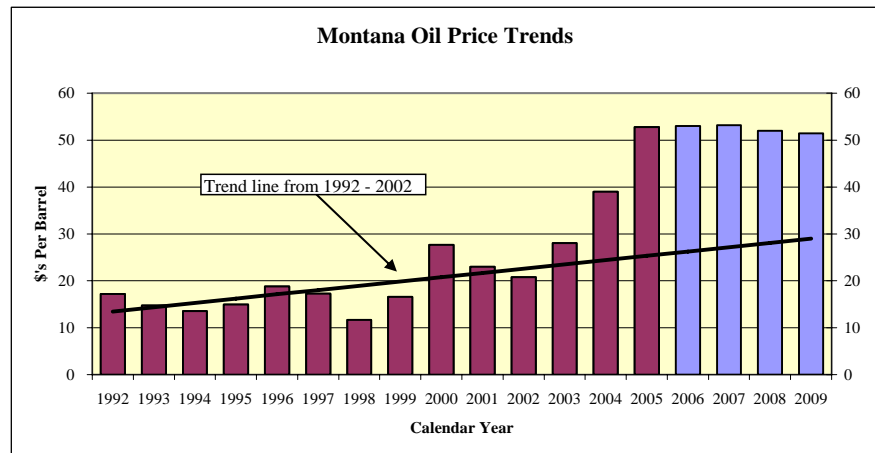
capital gains income is highly correlated to the S&P index. This would indicate that state tax revenues experienced significant growth from the mid to late nineties due to the information technology investment euphoria. In the meantime, while this growth scenario was occurring, state general fund expenditures were increased along with passage of significant tax relief measures. The actions of the legislature, in essence, expanded the expenditure base and reduced the tax base based on the assumption that strong revenue growth would continue indefinitely. Obviously, the budget crisis of 2002/2003 refuted this supposition. For the 2007 and 2009 biennia, an ominously similar pattern may be developing, clearly shown in Figure 4. Reliance on continued levels of capital gains income could lead to another fiscal crisis. A careful assessment of the long-term stability of these levels of income is warranted.

Figure 5

### Oil and Gas Production

Again for the 2007 and 2009 biennia, a similar situation may be developing in the oil and gas production component of state revenues. Montana's oil and natural gas revenues are increasing significantly when compared to previous biennia. The issue is whether these increased revenues are "on-going" or are a short-term "blip" (similar to net capital gains income) that may fade in the future.

Figure 6



Figures 5, 6, 7 and 8 show the trends in Montana's price and production for oil and natural gas. The data shown for calendar 1992 through 2005 are actual information extracted from the Department of Revenue's computer system. The estimates shown for the period calendar 2006 through 2009 are based on assumptions adopted by the Revenue and Transportation Committee (RTIC) on November 15, 2006.

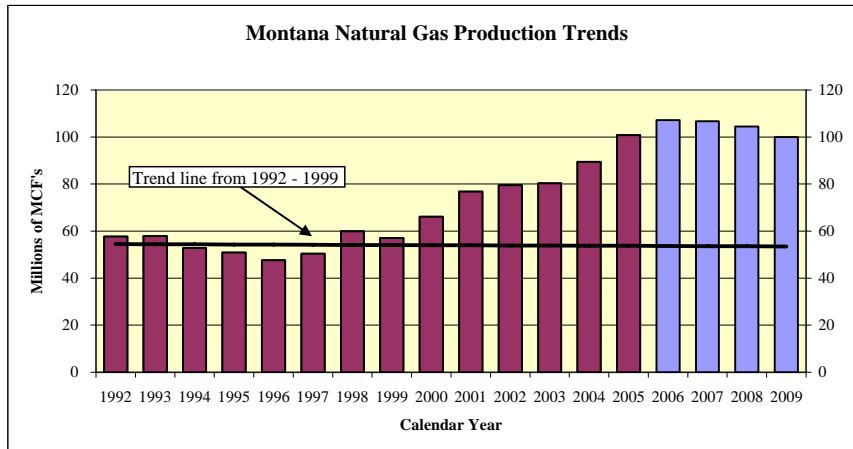
In addition to the actual and estimated amounts, the figures also show a trend line based on the calendar years indicated in the annotations. These trends are based on a common statistical technique that minimizes the differences between the trend estimate and the actual amount. The trend lines are extrapolated into the future to indicate what the "trend" would be under a status quo situation.

However, both oil and natural gas prices have increased dramatically in response to the war in Iraq and the uncertainty about future supplies.

The RTIC was aware of these conditions and adopted price and production assumptions accordingly. As shown in the figures, it is quite apparent that the price assumptions adopted by RTIC are expected to peak and then begin to trail off by the end of calendar 2009.

It is estimated that the additional revenue due to price and production being above the trend lines could be as much as \$70 million general fund or \$155 million all funds for calendar 2008 and 2009. These estimates most likely represent a maximum estimate since the

Figure 8



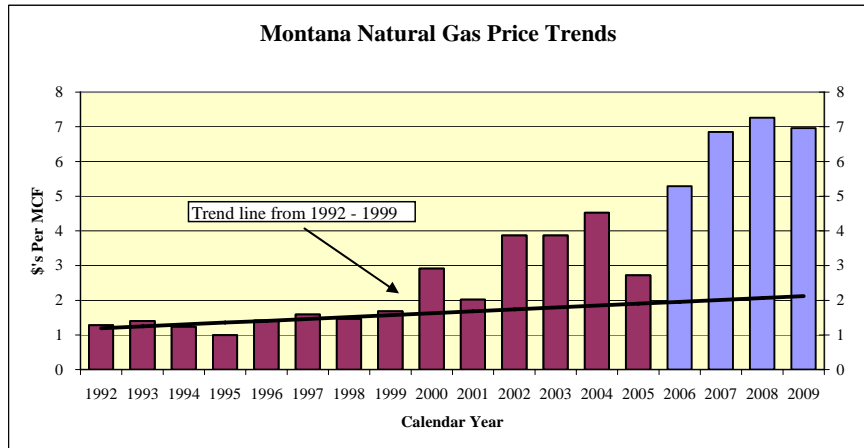
probability of price and production amounts returning to the trend line amounts are low. Regardless, the legislature should be visionary in the budgeting process and not assume oil and gas revenues will continue at these high levels unabated into the future.

directly tied to the national and world economic conditions and its erratic fluctuation. While corporate taxes are currently strong, it is again prudent to assess the long-term viability of reliance on sustaining this level of income into the future. A significant portion of corporate income taxes is being “fueled” by the natural resource industry. However, commodity prices could wreak havoc on corporate profitability. This is just one more example of a revenue source that may not be sustainable in future biennia. This issue is discussed in more detail in this volume and in Volume 2, “Revenue Estimates.”

### Revenue Stability-Summary

As shown in Figure 9, total general fund revenues have increased substantially during the period fiscal 2004 through 2006 and are projected to increase only moderately during FY 2007, 2008, and 2009. The projected dollar increases are consistent with the trends observed from FY 1995 through FY 1999.

Figure 7

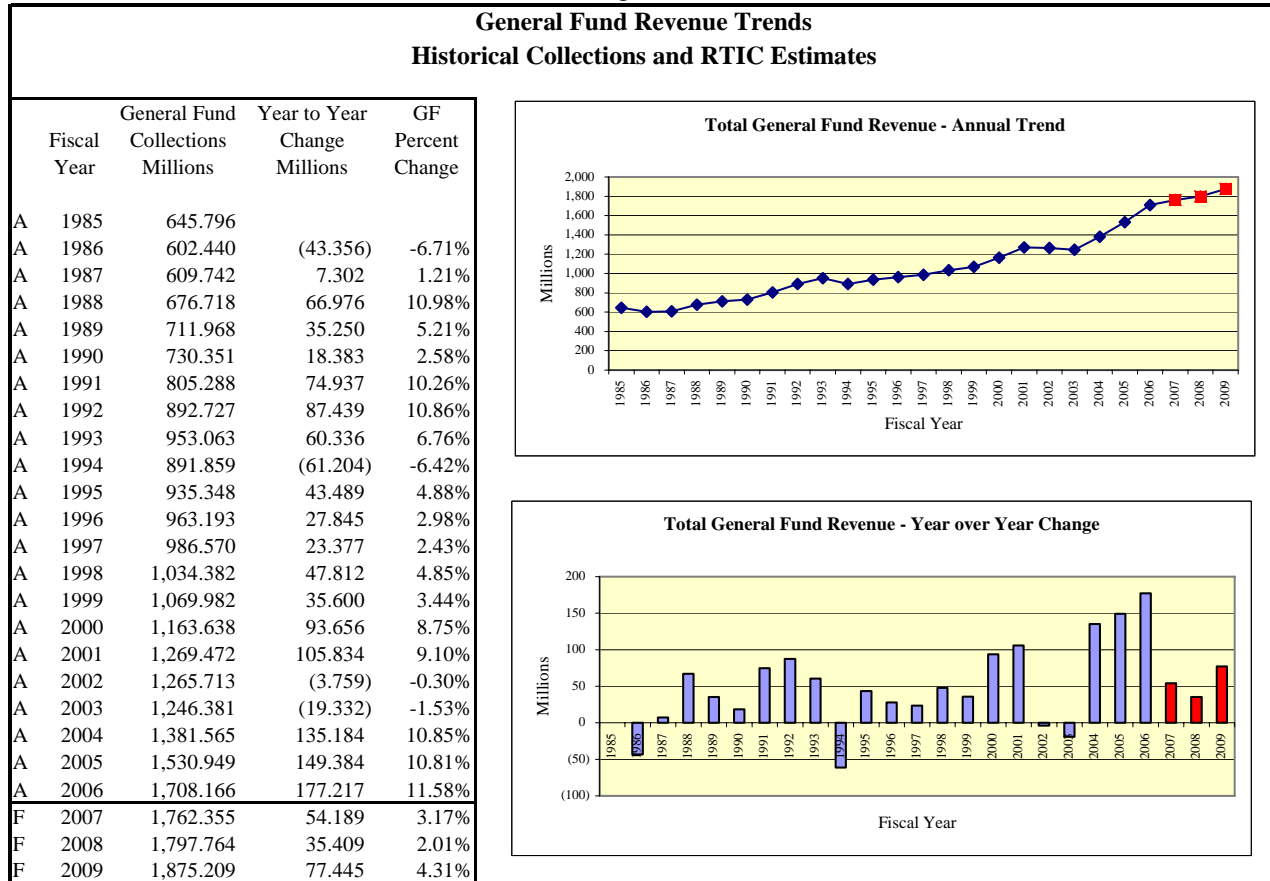


### Corporate Income

Corporate income taxes have traditionally been an extremely volatile source of revenue,



Figure 9



From a percentage growth perspective, however, the projected increases are generally a lower percent than in that previous period. Figure 9 also shows the change in revenue collections from year to year. The disturbing trend is the downturn in revenue collections observed at eight year intervals. If this pattern continues, the 2009 Legislature could be facing a difficult budget session.

The downturn in revenues during FY 2002/2003 illustrates the sensitivity of Montana's revenue stream to world events and investment opportunities. It also underscores the potential inaccuracies in the revenue estimates if the occurrences of these types of events are not known or are mistimed. Economic upturns or downturns are rarely accurately projected nor can disasters or certain world developments be anticipated. To quantify current collection patterns, the increased revenue collection of \$462 million from fiscal 2004 to 2006 was primarily due to three general fund revenue sources: individual income, corporation income, and oil and gas production taxes. Together, these three sources of revenue contributed about \$406 million of the total increase, which represents almost 88 percent of the total. The various assumptions used to estimate these revenue sources will have a substantial impact on total estimated general fund revenues in the future. If only a few of the key assumptions miss the mark, estimates may vary widely from actual collections.

## RELIANCE ON FEDERAL FUNDS

General fund expenditures have increased on average over 5.2 percent per year from fiscal 1990 to 2006. Correspondingly, federal funds expended have increased over 8.2 percent per year during this same period. In both funds, however, there have been some budgetary changes that skew these percentages. For example, HB124 (local government entitlement legislation), diverted some local government revenues to the state treasury in return for a state general fund entitlement appropriation to local governments. This change increased general fund revenues by approximately the same amount of increased general fund expenditures. During the 2003 biennium, the state food stamp program was included in the budgeting process. Prior to this time, this program was considered “off budget” and was not included as a federal fund expenditure.

Regardless of these changes, the fact remains that federal funds continue to be a much larger portion of the total state budget. As shown in Figure 10, general fund expenditures represented over 60 percent of the combined general and federal fund expenditures in FY 1990. By FY 1999, the percentage split was about equal. By FY 2004, however, federal funds represented over 55 percent of the combined spending to about 44 percent from the general fund. Interestingly, the federal funds percentage has returned to about 50 percent in FY 2006. Total federal funds expended in FY 2006 were \$1.572 billion compared to \$1.567 billion general fund, for a difference of \$4.9 million. If Montana was to lose a portion of these federal funds, the impact on the services provided to the citizens would be significantly reduced. To maintain the same level of services would require a substantial change in state tax policy.

Figure 10

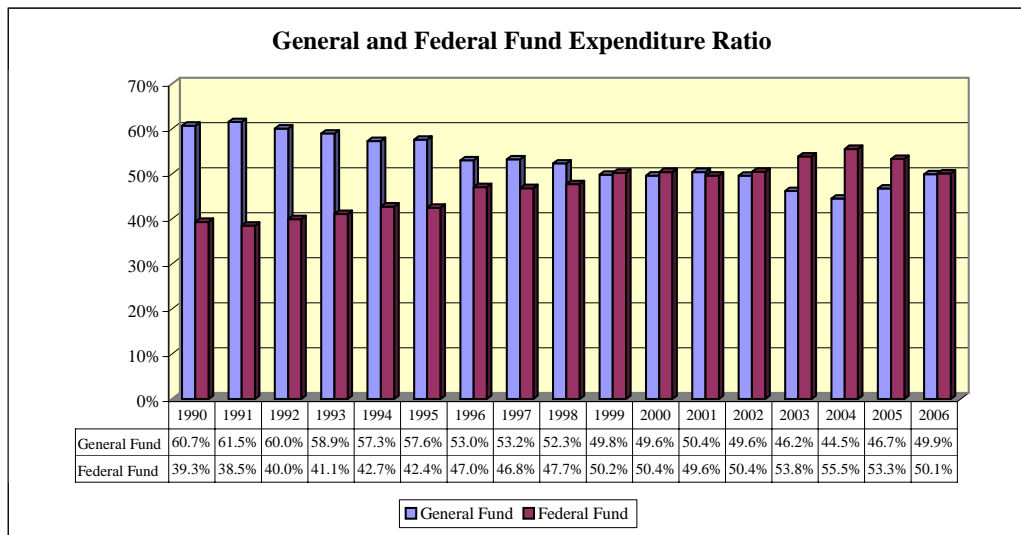
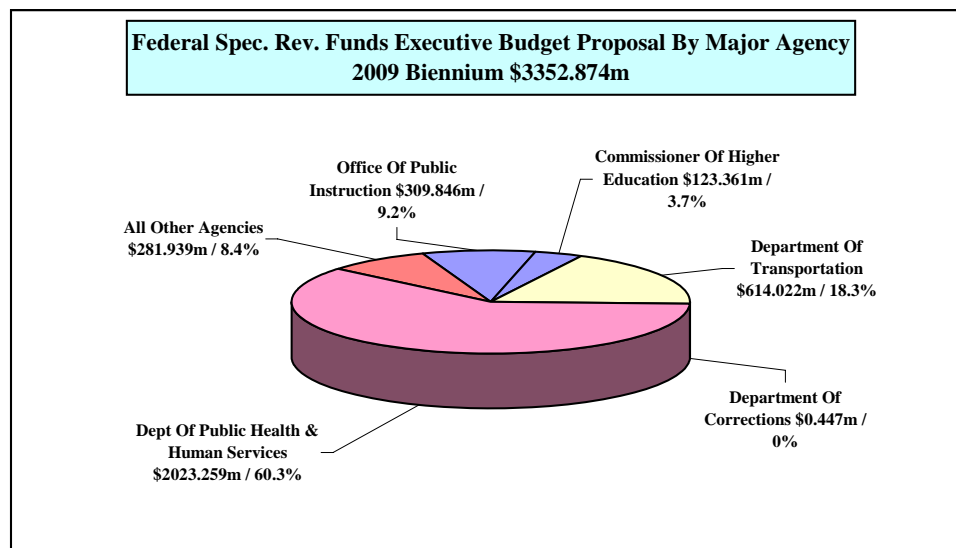


Figure 11 shows the 2009 biennium executive budget recommendation for federal special revenue funds. As the figure shows, public health and transportation services consume over 78 percent of the federal funds recommended in the executive budget. A reduction in federal funding would have a significant impact to these state programs.

Figure 11



### ***Reliance on Federal Funds-Summary***

With federal deficits and the continued Iraq war funding demands, the prospect for federal funding freezes or reductions is a real possibility, not only in the near-term but also in the long-term. The recent actions of the Bush administration to deal with large federal deficits, including passage of the deficit Reduction Act, signal a likelihood of federal cutbacks that may impact states. In this biennium, federal cut-backs in human services are felt, and are noted in this budget analysis. The 60<sup>th</sup> Legislature may want to consider developing a long-range plan in the event of a reduction in federal funds.

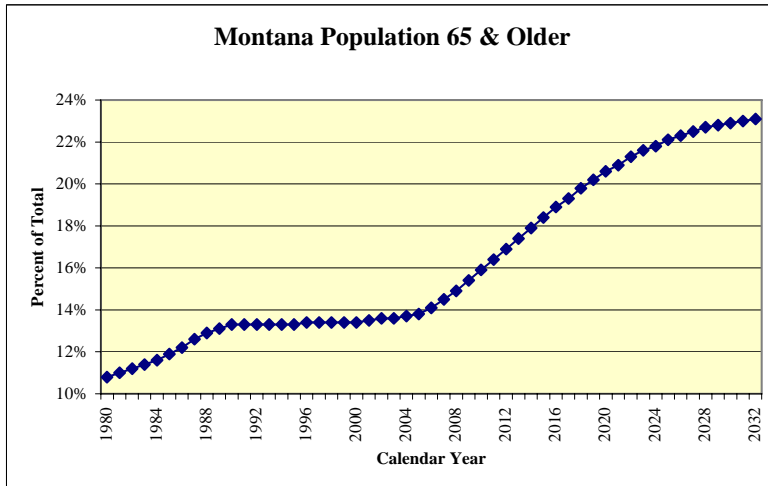
## **FUNDING DEMANDS**

Businesses as well as government constantly experience the changing and competing demands for available dollars. Whether a business is contemplating expansion or technology enhancements, state government experiences the same type of needs and priorities in order to continue services to the citizenry of the state.

### ***Aging Population***

One of the most significant events that is beginning to surface in Montana is the projected increase in the aging population. Between 2002 and 2025, Montana's population 65 and older is expected to increase from 13.6 percent of the total population to 22.1 percent, or a change in older residents of almost 100,000. As shown in Figure 12, Montana experienced rapid growth in this age cohort from calendar 1980 to 1990.

Figure 12



Starting in calendar 1991 through 2002, this trend waned with the percentage of residents in this age bracket remaining quite constant. From calendar 2002 to 2024 this trend is once again changing, showing a significant percentage of Montana's total population in the 65 and older age range. If these projections are correct, by calendar 2025 one out of every five Montanan's will be at least 65 years old.

The primary cause of this rising population change is the maturing of the baby-boomer generation, born

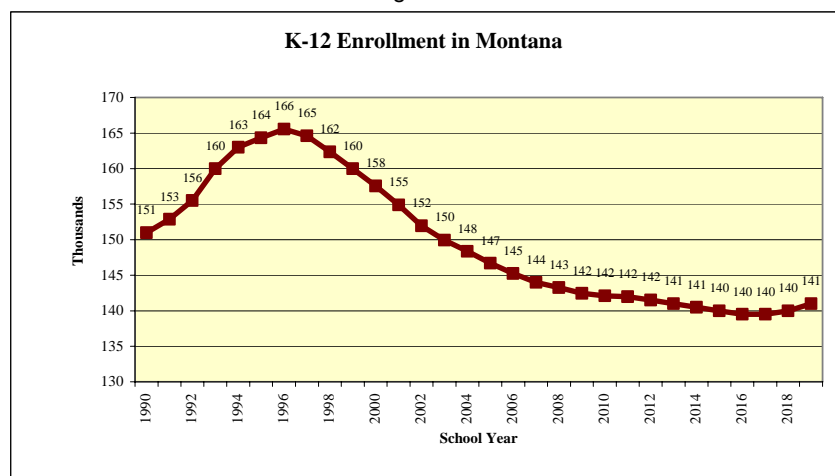
between 1946 and 1965. Montana, like other state and local governments, will need to address the issues relative to changing demographics. As Montana's population ages, issues relative to an economy that will be required to support these changes and the implications for medical and long-term care costs must be addressed.

With a growing elderly population, the legislature will need to address how the working-age population can support a significantly older population. In addition to the associated costs of caring for the elderly, the level of income these individuals have and ultimately how much they will pay in taxes could have a substantial impact on state government finances. Given the expected dramatic changes in the age structure of our population, it is imperative the legislature begin thinking about these issues and how they may be addressed in the future.

## School Enrollment

In addition to our aging population, Montana has experienced a significant change in enrollment in our elementary and secondary public schools. As shown in Figure 13, Montana's total enrollment was in excess of 165,000 children in school year 1996. From this time forward, total enrollment is expected to decline to about 140,000 students by school year 2015. Beyond 2015, enrollment is estimated to increase, but at a fairly moderate rate. The significance of this change is the costs associated with funding our current public school system. Under current law, state expenditures for public schools are primarily driven by the enrollment in each district. If enrollment declines, then the

Figure 13



cost to fund education correspondingly declines. See page 175 for a discussion on the current public school funding lawsuit.

If the current public school funding formula continues to be enrollment driven, the cost of funding the public school system will begin to accelerate when the current enrollment trends reverse direction beginning in school year 2015. At an average cost of about \$4,075 per enrollee per year, small changes in enrollment can turn into significant funding increases in the future.

### ***Funding Demands-Summary***

Changes in population demographics related to an aging population and a reversal of the decline in school enrollments are just two examples of funding demands. The chronic demands for increased human services and corrections funding are well known, and there are other troubling signs that funding demands could exacerbate the long-term stability of the general fund.

## **CONCLUSIONS**

Ensuring that the general fund is structurally balanced, i.e., that on-going revenues meet or exceed on-going expenditures for the next biennium, provides a simplistic short-term assessment of sustainability of the general fund. However, it does not take into consideration the long-term stability of the funds or whether long-term trend assumptions are based on sound fiscal policies. This section discussed three key issues related to long-term stability that may point to tougher times ahead. With regard to revenue stability, individual income taxes, oil and gas production taxes, and corporate income taxes account for 88 percent of revenue growth in the past three completed fiscal years. Further reliance on sustaining these revenues at current levels into the future would ignore ominous signs that warrant careful scrutiny. With regard to federal funds, the executive budget proposes replacement of \$12.3 million federal funds with general fund due to federal cutbacks, and this appears to be the tip of the cutbacks anticipated as the Federal government deals with huge deficits. Regarding funding demands, shifting demographics related to aging population and school enrollment, as well as challenging chronic growth patterns with corrections and human services, signal yet another reason for concern with long range stability of the general fund. Collectively, these sample issues bring into question the sustainability of an executive budget proposal that, while “structurally balanced” from a simplistic short-term perspective, may lead to budget shortfalls in the not-too-distant future.

#### **LFD ISSUE**

While revenue estimates and spending proposals in the executive budget may be based on the best information available, particularly with regard to future sustainability, if only a few key assumptions miss the mark, it could lead to budget shortfalls in the long-term. The legislature should carefully consider the issues surrounding the sustainability of the level of expansion proposed in this budget, and determine the level of risk that is acceptable in consideration of the vulnerability of any economic forecasting assumptions. For the longer-term, an in-depth analysis of the long-term stability of the general fund would require a fairly extensive analysis, but may be prudent given the serious impacts of over-extending based on erroneous assumptions.

The legislature may wish to recommend an interim study of the long-term stability of the general fund. Much could be learned from examining the fiscal policies on which the current general fund structure is based.

**LFD  
ISSUE  
CONT.**

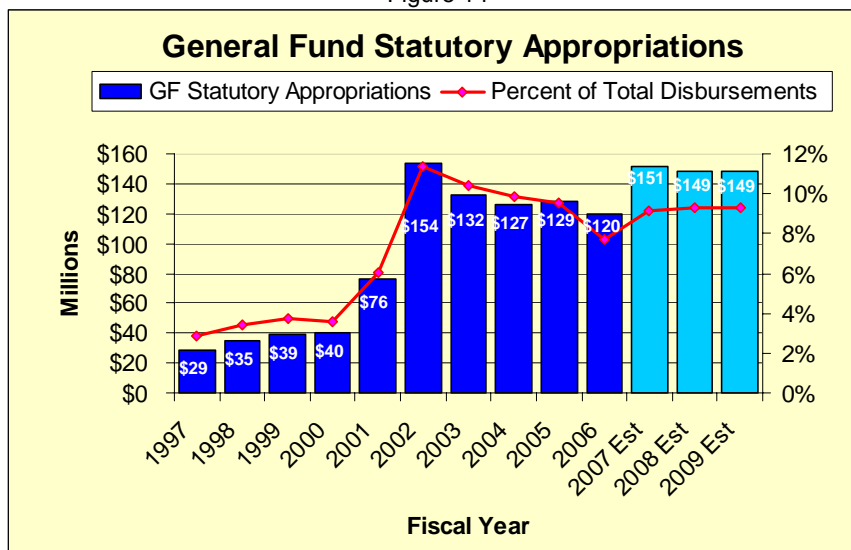
Based on this outlook, it could be argued that a significant amount of additional revenue in the next several years that is currently classified as “on-going” could be considered “one-time” and may not be available in subsequent biennia. If this hypothesis is correct, the 60th Legislature should consider creating a “rainy day fund” and transferring a portion of the potential one-time revenue into this fund. On November 28, 2006, the Legislative Finance Committee approved draft legislation that would create a “budget stabilization account”, a term synonymous with “rainy day fund”. Given the tenuous nature of some assumptions regarding the long-term sustainability of general fund, a rain-day fund would provide a cushion to get through the down-side of economic cycles.

## STATUTORY APPROPRIATIONS

### GENERAL FUND

Statutory appropriations are a special kind of legislative appropriation. Unlike temporary appropriations that expire in two years (such as those in the general appropriations act), statutory appropriations are, as their name suggests, in statute and are not part of the biennial budgeting process. As such, they are not automatically reviewed by the legislature and are not subject to the priority setting process like temporary appropriations (such as those in HB 2). Since the appropriations are in statute, they remain in place until removed or changed by legislation. The legislature has made various attempts to not lose sight of these appropriations. In 1985, Representative Bardanouve sponsored legislation that required all valid statutory appropriations to be contained in a list in 17-7-502, MCA. That list provides statutory citations for each statutory appropriation. Although there are currently 88 sections listed, some sections have multiple statutory appropriations and each appropriation listed in statute could have multiple appropriations established on the state accounting system. Of these, 21 sections statutorily appropriate general fund. In 1993, Senator Grosfield successfully sponsored legislation (SB 378) that required a review of all statutory appropriations every two years by the Legislative Finance Committee. This requirement was removed by the 2001 legislature. Statutory appropriations are intended for only limited situations, and guidelines for the appropriateness for establishing them are specified in 17-1-508, MCA.

Figure 14



The significance of statutory appropriations lies not in the number of them, but rather in the amount of money authorized to be spent and whether the authorizations still reflect the priorities of the current legislature. All statutory appropriations are available for the legislature to review, prioritize, and change if desired. Figure 14 on the left illustrates the amount of general fund spent through statutory appropriations from FY 1997 through FY 2006 and estimated amounts from FY 2007 to FY

2009. From FY 1997 to FY 2006, general fund expenditures from statutory appropriations increased \$91.4 million and, in FY 2006, comprised 8 percent of all general fund expenditures. For the 2009 biennium, \$297.6 million general fund is expected to be spent with statutory appropriations. The initiation of the county entitlement program in FY 2002 (enacted by HB 124 in the 2001 session) accounts for most of the large increase shown in FY 2002. The increase in FY 2001 is largely due to payment of wildfire costs incurred during the summer of 2000.

Figure 15 shows each individual general fund statutory appropriation that has been included in the general fund balance sheet for FY 2007-2009. The largest statutory appropriation of general fund occurs under 15-1-121, MCA. For the 2009 biennium, \$181.0 million is expected to be spent for entitlement payments to counties and tax increment financing districts. Other large statutory appropriations of general fund in the 2009 biennium include:

- \$45.6 million of transfers to retirement funds (Title 19, MCA)
- \$38.1 million to service the debt on bonding issues approved by past legislatures (17-7-502, MCA)
- \$12.1 million of coal trust interest (that is deposited to the general fund) to fund economic development programs (15-35-108, MCA)

**LFD  
Issue**

### County Entitlement Payments

As stated above, \$181.0 million of general fund is projected to be spent in the 2009 biennium through statutory appropriations for entitlement payments to counties and tax increment financing districts. By statute, subsequent yearly amounts are automatically increased by a calculated growth factor. Because the money is appropriated in statute, it is not reviewed by the legislature as part of the biennial budgeting process. In essence, it and all other general fund statutory appropriations have priority funding over all general fund programs appropriated in the general appropriations act (HB 2). When the legislature is prioritizing general fund programs to balance the budget, programs funded with general fund statutory appropriations should be considered by the legislature along with all other general fund programs.

As an alternative to funding counties and tax increment financing districts entitlement payments through statutory appropriations, the legislature could eliminate the statutory appropriations and provide appropriations for the program in HB 2. This would ensure that the program and the appropriations are reviewed and prioritized along with the other general fund programs in HB 2 each biennium, and that the level of funding reflects the current legislature's funding priorities.

**LFD  
Issue**

### Economic Development

Initially enacted in the May 2000 Special Legislative Session to fund programs not funded by the invalidation of the coal producer's license tax passed by the 1999 Legislature, HB 1 statutorily appropriated general fund from coal trust interest to stimulate economic activity. Although originally scheduled to terminate at the end of FY 2005, \$6.1 million annually of general fund for these programs has since been permanently statutorily appropriated.

Given the current strong state of Montana's economy, the legislature may wish to review the need and usefulness of these general fund statutory appropriations.



**LFD  
Comment**
**Executive Proposals**

The Executive Budget proposes legislation to increase the governor's general fund biennial statutory appropriation for emergencies from \$16.5 million to \$25.5 million. Although the entire \$25.0 million is listed as being one-time in nature, the appropriation would become permanent. Because the increase in the appropriation requires passage of legislation, the increase is not included in the Legislative Fiscal Division's general fund balance, but the current statutory amount of \$16.5 million is split between FY 2008 and FY 2009.

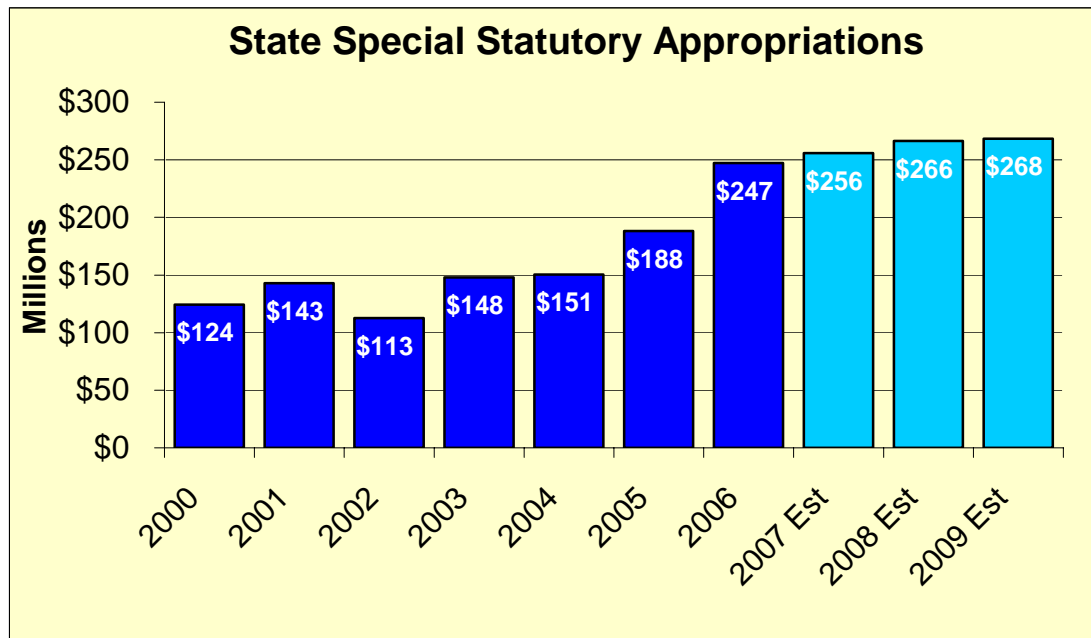
**Figure 15**  
**General Fund Statutory Appropriation Estimates**  
**Fiscal Years 2007-2009**  
(in millions)

| MCA Cite                           | Bill/Purpose                                    | Fiscal 2007  | 2009 Biennium |              |              |
|------------------------------------|---|--------------|---------------|--------------|--------------|
|                                    |   |              | Fiscal 2008   | Fiscal 2009  | Total        |
| <b><u>Retirement</u></b>           |   |              |               |              |              |
| 19-9-702                           | Ins Prem Tax-Fire/Polc Ret 19-9-702-SA          | \$8.617      | \$9.076       | \$9.559      | \$18.634     |
| 19-13-604                          | Prem Tax-Fire/Pol 19-13-604-SA                  | 7.874        | 8.231         | 8.604        | 16.835       |
| 19-17-301                          | Prem Tax-Fire/Pol 19-17-301-SA                  | 1.698        | 1.791         | 1.888        | 3.679        |
| 19-18-512(1)                       | Prem Tax-Fire/Pol 19-18-512-SA                  | 0.262        | 0.275         | 0.288        | 0.563        |
| 19-19-305(1)                       | Prem Tax-Fire/Pol 19-19-305-SA                  | 0.250        | 0.250         | 0.250        | 0.500        |
| 19-19-506(4)                       | Prem Tax-Fire/Pol 19-19-506-SA                  | <u>0.021</u> | <u>0.021</u>  | <u>0.021</u> | <u>0.041</u> |
| Sub-total                          |   | \$18.722     | \$19.643      | \$20.609     | \$40.252     |
| <b><u>Economic Development</u></b> |   |              |               |              |              |
| 15-35-108(7)(b)(i)                 | Coop Developmental Center NMC                   | \$0.065      | \$0.065       | \$0.065      | \$0.130      |
| 15-35-108(7)(b)(ii)                | Add Vision 2005-SA                              | 1.250        | 1.250         | 1.250        | 2.500        |
| 15-35-108(7)(b)(iii)               | Research & Commercialization                    | 3.650        | 3.650         | 3.650        | 7.300        |
| 15-35-108(7)(b)(iii&iv)            | Economic Development                            | <u>1.100</u> | <u>1.100</u>  | <u>1.100</u> | <u>2.200</u> |
| Sub-total                          |   | \$6.065      | \$6.065       | \$6.065      | \$12.130     |
| <b><u>Other</u></b>                |   |              |               |              |              |
| 10-3-312(1)                        | Emergency Appropriations                        | \$15.509     | \$8.250       | \$8.250      | \$16.500     |
| 15-1-111(6)                        | Local Assistance-Property Tax Reduction         | 2.408        | 1.204         | 0.000        | 1.204        |
| 15-1-121(3)                        | HB124 Combined Local Entitlement Distribution   | 83.870       | 87.097        | 90.487       | 177.584      |
| 15-1-121(6)                        | HB124 Local TIF Entitlement Distribution        | 1.725        | 1.725         | 1.725        | 3.451        |
| 15-70-601(1)(b)                    | HB 756-Biodiesel tax incentives (begins FY2008) | 0.000        | 0.000         | 0.000        | 0.000        |
| 15-70-369(4)                       | HB 776-Biodiesel tax refunds                    | 0.048        | 0.096         | 0.096        | 0.192        |
| 16-11-509                          | HB 169-Fines & cost recovery tobacco settlement | 0.030        | 0.030         | 0.030        | 0.060        |
| 17-3-106(2)                        | DofA Cash Management Interest                   | 0.230        | 0.230         | 0.230        | 0.460        |
| 17-6-101(6)                        | BOI Banking Charges                             | 1.180        | 1.180         | 1.180        | 2.359        |
| 17-7-502(4)                        | TRANS Debt Service and Issuance Costs           | 0.000        | 0.000         | 0.000        | 0.000        |
| 17-7-502(4)                        | Transfer to Debt Service A/B Bond               | 19.112       | 20.560        | 17.500       | 38.060       |
| 19-20-604                          | Teachers GABA 19-20-604                         | 0.724        | 0.757         | 0.791        | 1.548        |
| 19-3-319                           | Local Government PERD 19-3-319                  | 0.461        | 0.479         | 0.498        | 0.977        |
| 19-6-410                           | HB 102-Supplemental retirement benefits for MHP | 0.285        | 0.300         | 0.300        | 0.600        |
| 19-6-404(2)                        | HB 102-To highway patrol retirement fund        | <u>1.050</u> | <u>1.103</u>  | <u>1.103</u> | <u>2.205</u> |
| Sub-total                          |   | \$126.631    | \$123.011     | \$122.189    | \$245.200    |
| Total                              |   | \$151.418    | \$148.719     | \$148.863    | \$297.581    |

## STATE SPECIAL

It is estimated by the executive that \$534.9 million of state special revenue will be spent through statutory appropriations in the 2009 biennium. Figure 16 shows the amounts spent from FY 2000 through FY 2006 and the amounts estimated by the executive to be spent from FY 2007 through FY 2009. In fiscal 2006, the agency with the largest expenditures of state special revenue (\$104.1 million) with statutory appropriations was the Department of Revenue. This department distributes revenue from oil, natural gas, metalliferous mines, beer, wine, and liquor taxes to local and tribal governments. The agency with the second largest expenditures is the Office of Public Instruction, which distributes net interest and income from the school trust to pay interest of the SB 495 loan and to fund public schools. The five agencies with the largest expenditures spent \$230.6 million or 93.3 percent of the \$247.2 million total. By far, the largest single purpose for which the money was spent (\$216.2 million or 93.7 percent) was to transfer the money to local governments.

Figure 16

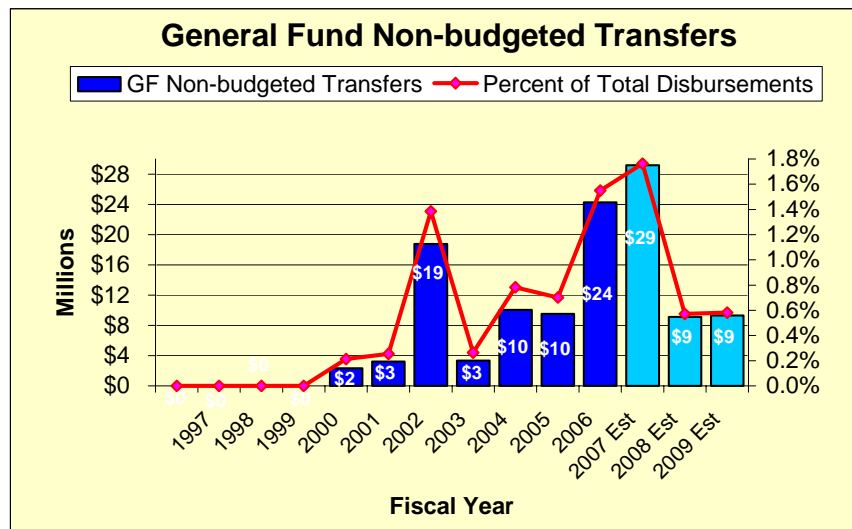


## GENERAL FUND NON-BUDGETED TRANSFERS

The Montana Constitution requires that all money paid out of the state treasury, except interest paid on the public debt, be done with an appropriation. However, the state treasury consists of numerous accounts and, with proper legislative authorization, money may be transferred from one account to another without an appropriation. This results in less money in one account for the programs it funds and more in another. Like statutory appropriations, these transfers and their authorizations are in statute (or sometimes contained in legislation) and are not part of the biennial budgeting process, yet they affect the amount of money available for the legislature to appropriate for specific programs. Because they are in statute, they remain in place until removed or changed by legislation.

Since FY 2000, increased amounts of money have been transferred out of the general fund to other accounts that fund non-general fund programs. As illustrated in Figure 17, this amount has grown from \$0 in FY 1999 to \$29 million in FY 2007 (about 1.8 percent of total general fund expenditures), and transfers are estimated to be \$18.4 million in the 2009 biennium. The amount in FY 2007 includes a one-time transfer of \$19.4 million to the capital project fund. These transfers reduce the amount of money in the general fund that is available for general fund programs and increase the amount available for other non-general fund programs. Figure 18 shows each non-budgeted general fund transfer that has been included in the general fund balance sheet.

Figure 17



### LFD ISSUE

#### MCA Title 15 Transfers

The largest group of transfers out of the general fund is the transfer of motor vehicle fee and other revenue that is initially deposited to the general fund (15-1-122, MCA). This money is then earmarked and transferred out to multiple accounts to fund various state programs. The practice of transferring money out of the general fund escalated sharply with the enactment of HB 124 (entitlement payments to counties) in the 2001 session. The practice is not conducive to good budgeting and unnecessarily complicates the revenue and disbursement processes. The legislature could eliminate this complicated and unnecessary practice and achieve the same results by implementing one of the following:

- Earmark the applicable fees and provide for their direct deposit to the various program accounts. This bypasses the unnecessary step of first depositing the money in the general fund and then transferring the general fund to the various program accounts. Since the money is already being appropriated from these program accounts, current appropriations would not change.

**LFD  
Issues  
Cont.**

- Continue to deposit the applicable fees to the general fund, but eliminate the transfers to the various program accounts. Since there would be no transfer revenue to appropriate from the various program accounts, appropriations from these accounts would be eliminated and replaced by general fund appropriations in the same amounts. In both cases, the various state programs receive the same level of appropriation and the general fund transfers are eliminated.

Figure 18  
General Fund Non-budgeted Transfer Estimates  
Fiscal Years 2007-2009  
(in millions)

| Authorization                      | Name  | Actual       | 2009 Biennium |              |              |
|------------------------------------|---|--------------|---------------|--------------|--------------|
|                                    |   | Fiscal 2007  | Fiscal 2008   | Fiscal 2009  | Total        |
| <u>Vehicle/Other Fee Transfers</u> |   |              |               |              |              |
| 15-1-122(1)                        | DPHHS-Adoption services                       | \$0.054      | \$0.059       | \$0.065      | \$0.124      |
| 15-1-122(2)(c,d)                   | DOT-Nonrestricted account                     | 3.096        | 3.142         | 3.190        | 6.332        |
| 15-1-122(3)(a)                     | DEQ-Junk vehicles                             | 1.733        | 1.750         | 1.791        | 3.541        |
| 15-1-122(3)(b)                     | Agriculture-Noxious weeds                     | 1.756        | 1.773         | 1.816        | 3.589        |
| 15-1-122(3)(c)(i)                  | FWP-Boat facilities & enforcement, OHV, Parks | 0.539        | 0.544         | 0.557        | 1.101        |
| 15-1-122(3)(c)(ii)                 | FWP-Enforcement, snowmobiles                  | 0.117        | 0.118         | 0.121        | 0.239        |
| 15-1-122(3)(c)(iii)                | FWP-Motorboats                                | 0.187        | 0.189         | 0.194        | 0.383        |
| 15-1-122(3)(d)                     | MA-Veterans' services                         | 0.749        | 0.757         | 0.775        | 1.531        |
| 15-1-122(3)(e)                     | DOT-Disabled seniors transportation           | 0.351        | 0.355         | 0.363        | 0.718        |
| 15-1-122(3)(f)                     | MA-Search and rescue                          | <u>0.047</u> | <u>0.047</u>  | <u>0.048</u> | <u>0.096</u> |
| Sub-total                          |   | \$8.629      | \$8.735       | \$8.919      | \$17.654     |
| <u>Other Transfers</u>             |   |              |               |              |              |
| Unknown                            | DPHHS Nonbudgeted                             | \$0.391      | \$0.391       | \$0.391      | \$0.781      |
| 39-71-2352(6)                      | Old state fund shortfall                      | Unknown      | Unknown       | Unknown      | Unknown      |
| 53-20-171(2)                       | Developmental disability tax credit excess    | Unknown      | Unknown       | Unknown      | Unknown      |
| Un-codified                        | HB 5-to the capital projects fund             | 19.400       | 0.000         | 0.000        | 19.400       |
| Un-codified                        | HB 6-to renewable resource grant account      | 0.600        | 0.000         | 0.000        | 0.600        |
| Un-codified                        | HB 740-to asbestos disease account            | 0.175        | 0.000         | 0.000        | 0.175        |
| Un-codified                        | HB 761-reimburse military ins. premiums       | 0.000        | 0.000         | 0.000        | 0.000        |
| 41-5-130(6)                        | HB 414-to youth prevention account            | <u>0.000</u> | <u>0.000</u>  | <u>0.000</u> | <u>0.000</u> |
| Subtotal                           |   | \$20.566     | \$0.391       | \$0.391      | \$20.956     |
| Total                              |   | \$29.195     | \$9.125       | \$9.310      | \$38.610     |

## FUND BALANCE ADEQUACY/RESERVES

Following the severe revenue shortfalls that began in FY 2002 and continued into early FY 2004, the Montana economy has had a pretty good run. This is apparent in revenue projections through the 2009 biennium adopted by the Revenue and Transportation Interim Committee and in the projected ending fund balance. However, there is no shortage of spending proposals to be considered by lawmakers that will be convening in January 2007, including proposals for spending in the executive budget. In addition, much of the projected balance can be characterized as “one-time” revenues that, in theory, should not be spent on on-going programs. The legislature needs to be aware of the tenuous nature of the projections and keep in mind the need to maintain an adequate reserve.

Attaining general fund budget stability means more than setting appropriations equal to anticipated revenues, with a positive ending fund balance serving as a safety net. The adequacy of the state general fund balance can signify the difference between whether or not the state is forced to confront the unpleasant consequences of fiscal instability.

Montanans are all too familiar with the consequences of general fund balance inadequacy. In the late 1980's and early 1990's, the state general fund experienced a chronic deficit between revenues and disbursements. Much of the growth in the disbursement rate is a result of natural growth in expenditures due to inflation and/or caseload and enrollment increases, as well as supplemental spending for such contingencies as fire suppression. Revenue growth in the state has not always kept pace with expenditure growth. During the 2003 biennium, actual revenue growth was well below forecasts, primarily because of reduced income tax collection and lower interest rates, largely due to circumstances that could not be predicted when the 2003 biennium budget was being approved. The legislature adjourned from the 2001 regular session with a projected 2003 biennium general fund ending balance of \$54 million (2.3 percent of biennial appropriations). By the end of the first fiscal year, revenue collections for the biennium were \$153 million below legislative estimates. Even after the Governor directed statutory spending reductions of \$23 million, a special session was necessary to achieve an acceptable ending fund balance reserve through an additional \$59 million in budget balancing actions. Revenues still remained unstable as the Fifty-eighth Legislature imposed additional reductions as it shaped the 2005 biennium budget, ending the session with a projected fund balance of \$46.2 million or 1.7 percent. As we are now aware, revenue collections are running well ahead of estimates, and the 2007 legislature faces an unprecedented level of general fund resources as it prepares to craft the 2009 biennium budget.

Recognizing that budgetary imbalances and revenue swings can occur, the state can either take a reactive or a proactive approach. During the 1993 and 1995 biennia, the state held three special legislative sessions to deal with budget shortfalls. Another occurred in August of 2002. Although special sessions allow lawmakers the ability to address issues relative to revenues and expenditures, special sessions can cost the taxpayers more than \$50,000 per day. The need for special sessions is also closely scrutinized by the national agencies that rate the state's debt. Rating agencies also use a state's general fund balance as a percent of revenues as one of the key financial indicators for credit analysis.

Again from a reactive stance, budgetary fluctuation can be temporarily resolved through spending reductions. In accordance with 17-7-140, MCA, the Governor can authorize spending reductions: “...in an amount that ensures that the projected ending general fund balance for the biennium will be at least 1 percent of all general fund appropriations during the biennium.” Essentially, the executive branch

assumes control of the budget decision-making process by implementing and prioritizing spending reductions. Further, budgetary imbalances can be addressed only from one side of the equation -- expenditures. This means that legislative priorities could potentially get lost in the process.

Because of the cost and disadvantages of taking a reactive approach to budget imbalances, a more effective method may be to approach these issues proactively through provision of adequate fund balance reserves. National fiscal experts such as the National Conference of State Legislatures (NCSL) recommend a reserve fund balance of 3 to 5 percent of total appropriations or revenues. Because Montana's budget is implemented on a biennial basis -- resulting in considerably more risk than an annual budgeting process -- the 3 to 5 percent should be applied to biennial totals. For Montana, with projected total general fund revenues of \$3.6 billion, a minimum 3 percent reserve equates to a \$108.0 million ending fund balance. The revenue volatility of recent years might suggest that an even higher reserve would be more prudent.

The provision of an adequate general fund balance is essential to achieving a sound financial foundation. The level of fund balance reserves must be sufficient to offset the volatility of revenues and the potential for unforeseen expenditure increases, both of which are prevalent in recent years and in current budget proposals. It is even more important since Montana is one of only three states that do not have a rainy day fund provision (although the legislature is expected to consider one or more "rainy day fund" bills this session). To this end, the legislature will again need to determine what amount of ending fund balance is sufficient to ensure budget stability.

The executive budget balance sheet shows an ending fund balance of approximately \$241.3 million. However, the executive document recommends a fund balance of \$100 million, or 2.8 percent, and suggests that the remaining funds be set aside for the "Big Sky Savings Account", a reserve to offset potential revenue shortfalls in the future. The proposal for a \$100 million ending fund balance is very close to the 3 percent level that national experts suggest as a minimum reserve, and is a significant improvement to the levels recommended and adopted in past session.

**LFD  
ISSUE**

The executive proposal for a \$100 million ending fund balance reserve includes an allowance for wildfire suppression costs and the statutorily appropriated emergency fund in the calculation of the reserve. This is the first time an administration has included these expenditures in the projected reserve. The LFD projections also include allowances for these costs, except for the increases proposed by the executive as a new proposal, since they would be added if and when the bill passes. However, the legislature has never included these items in their calculation of the projected ending fund balance that they adopt each session. It can be argued that this misrepresents the likely ending fund balance that can be anticipated, since in both cases some level of expenditure is certain, and an average yearly expenditure can easily be calculated. When a minimum reserve of 3 to 5 percent is recommended, an assumption made is that it includes a reasonable estimate of actual revenues and expenditures, and that known liabilities are not unjustifiably left out.

**LFD  
ISSUE  
CONT.**

The cost of wildfire suppression is rising rapidly due to more expensive means of fighting fires and reductions in federal support for fire costs. The average cost of wildfire suppression over the past seven years, with high and low years removed, is \$13.3 million. Further, the statutory appropriation for emergencies is \$16.5 million, and the executive proposal would raise it to \$25.5 million due to recent demands on the fund, mostly related to wildfire costs. Since supplemental appropriations are by definition “unexpected” expenditures, they are typically not included in fund balance projections. However, the argument can be made that wildfires shouldn’t be considered a true supplemental to the extent of the full cost of wildfire suppression, since it is a known, but unbudgeted annual expenditure. All other supplementals are above a base level of expenditures that has been included in the budget, and not zero based, like wildfires. And the emergency appropriation is an authorized level of expenditure, albeit only for emergencies that are by nature unpredictable. Yet all other statutory appropriations are estimated and included in calculating projected ending fund balance. This inconsistent application could be mitigated by at least including an average year allowance in the fund balance calculation, or to fully include the established appropriations for wildfire costs, as the executive has done.

If an allowance for wildfire suppression and expenditures from the emergency fund are included in the fund balance calculation, then the true fund balance reserve is well below the recommended minimum 3 percent.

It is recommended that as a matter of good fiscal policy, the legislature consider including an estimate of expenditures for wildfire suppression and emergency fund spending in the calculation of the projected ending fund balance reserve.

## OTHER MAJOR FUNDS

### HIGHWAYS STATE SPECIAL REVENUE ACCOUNT DECLINING WORKING CAPITAL BALANCE

The executive is presenting a balanced budget for the highways state special revenue account (HSSRA) for the 2009 biennium. In relation to the annual expenditures from the account, the balance entering the 2009 biennium is cautiously low. In the past, the account has been in a period of decline, as more funds were spent than were received in revenues. If historical levels of reversions are considered for FY 2007, the account is projected to end the 2007 biennium with a working capital balance of \$12.5 million, which is down from a \$27.2 million balance at the end of FY 2006. Without reversions, the balance will be depleted before the end of the 2007 biennium. For the 2009 biennium, projections indicate that revenues will exceed expenditures by \$25.0 million and the balance will improve. The balance includes the executive proposal to minimize state funded construction activities to the level necessary to secure the most advantageous federal match rate.

Revenues into the account, which are from highway users fees, primarily comprised of motor fuel tax collections and gross vehicle weight fees, are expected to increase at an average annual growth rate of 2.2 percent from FY 2007 through FY 2009. Revenue growth is due in large part to the diesel fuel tax revenues that are expected to grow at about 12 times the rate of gasoline taxes, but which contribute only 60.0 percent as much revenue as gasoline taxes.

The executive budget will match all federal funds apportioned to Montana for the 2009 biennium under the latest long-term federal highway funding legislation. On average, Montana receives about \$78.0 million, which represents a 30 percent increase more per year under the new legislation than it received under the previous legislation. High cost inflation for construction materials have nearly offset the gains Montana made from the funding increase.

#### ***Federal Funds Balance Being Depleted***

Estimates made by federal budgeting entities project that the balance of the federal Highway Trust Fund will decline and be depleted, possibly as early as federal fiscal year 2009. That trust fund is the source for federal-aid funds for the construction of many of Montana's highways. Deficits or a declining balance of the federal fund could impact the amount of federal aid Montana receives to spend on its highway infrastructure. Declining federal aid could also increase pressures to use state funds to minimize the impacts of reduced federal funds.

#### ***Summary***

As stated, the executive budget presents a balanced budget from the account. When considering initiatives to expand the use of state funds for highways, the legislature may want to consider the impacts high construction cost inflation is having on the purchasing power the state has for maintaining its highways and on the impacts decreased federal aid would have on the state construction program and its ability to maintain the condition of the state's highway infrastructure at a satisfactory condition.

This issue is presented in more detail in the Department of Transportation budget discussion in Volume 3, General Government and Transportation Section; page A-94.



## RESOURCE INDEMNITY TRUST (RIT)

The following is a brief summary of the Resource Indemnity Trust and related issues. For detailed information in the trust, please see the agency issues section of the Department of Natural Resources and Conservation in Volume 5, page C-138.

Article IX of the Montana Constitution provides for the protection and improvement of the Montana environment and requires the legislature to provide adequate remedies for environmental protection from degradation. It specifically requires “all lands disturbed by the taking of natural resources shall be reclaimed”, and requires the existence of a resource indemnity trust (RIT) fund for that purpose, to be funded by taxes on the extraction of natural resources.

The Constitution further states, “The principal of the resource indemnity trust shall forever remain inviolate in an amount of one hundred million dollars (\$100,000,000) guaranteed by the state against loss or diversion.”

The state constitution requires a trust, but does not require the trust to be funded. The legislature utilized certain natural resource extraction tax proceeds as a revenue source for the trust. In February of 2002, the Governor certified that the balance of the trust had exceeded the \$100 million threshold. Consequently, those tax proceeds previously directed to the RIT were re-directed by the 2003 and 2005 Legislatures and the trust no longer receives revenue. The 2005 Legislature also approved a joint resolution to address the issues associated with the RIT.

### ***HJR 36 Study***

HJR 36 was proposed as a means to address the multiple issues associated with the Resource Indemnity Trust (RIT) and related funds that were identified through the budget analysis and appropriations process during the 2005 Legislature. This included issues such as: 1) fund utilization in conflict with statutes; 2) confusion regarding the flow of interest income and taxes; and 3) coordination among multiple agencies. To meet the terms of the resolution, the Legislative Finance Committee (LFC) established an RIT subcommittee to complete the tasks. The LFC adopted the full recommendations of the RIT subcommittee. There are three types of recommendations: recommendations requiring legislation, other recommendations, and red flags.

### ***Recommendations Requiring Legislation***

The Legislative Finance Committee has requested legislation to implement the recommendations. A summary of the recommendations included in LC 0147 are:

- Statutory clean-up to increase clarity of all fund statutes in regard to fund purpose and fund utilization.
- Revise allocation of RIGWA taxes to correct funding shortfalls in the hazardous waste fund and the environmental quality protection fund rather than depositing the funds to the orphan share.
- Eliminate statutory appropriations of RIT interest to the oil and gas damage mitigation fund and MSU-Northern, as they do not meet the criteria for statutory appropriations.
- Remove the cap on the groundwater assessment fund to allow the program to actively seek additional funding.
- Eliminate the renewable resource and reclamation and development funds and provide for a natural resource program operating fund and project fund to eliminate cross competition for funding.

- After the program sunsets, transfer the balance of the natural resources scholarship fund to the water storage fund to assist with the backlog of rehabilitation projects on state owned water projects.

A second piece of legislation, SB 77 amends the future fisheries statute to clarify the type and scope of information to be provided to a specific body of the legislature regarding the investment in the future fisheries program

### ***Recommendations – Not Requiring Legislation***

The LFC recommended to the Legislative Audit Committee two programs for performance audits: the orphan share program and the future fisheries program. Each program had issues that the LFC felt needed additional attention. The orphan share audit was approved by the audit committee and should be completed by the spring of 2007. The future fisheries audit was not approved by the audit committee.

### ***Red Flags***

During the process, issues arose that were related to RIT programs but were not within the parameters of the study. They are the backlog of rehabilitation of state water projects and the funding formula for the Natural Resources Information System (NRIS). Those issues are addressed in the Water Resource Division of the Department of Natural Resources in Volume 5 and in the Library Commission in Volume 7.

### ***Budget Request and Proposed Changes***

The proposed legislation does provide some relief on the issues identified prior to and during the study. This includes reallocation of RIGWA taxes to eliminate inter-fund transfers, consolidation of grant and loan programs, elimination of two funds from the RIT matrix, and clarification of the utilization of related funds.

In order for the legislature to see the difference, the RIT expenditure table has been completed based on the executive's requests and the proposed legislative changes. Figure 19 represents the executive request under current law and Figure 19 represents the executive's request under the proposed legislative changes.

Figure 19

Executive Request  
Resource Indemnity Funding

| Related Funds                                      | 02010<br>Oil & Gas | 02022<br>Future<br>Fisheries | 02070<br>Hazardous<br>Waste | 02162<br>EQPF <sup>1</sup> | 02216<br>Water<br>Storage | 02272<br>Renewable<br>Resources | 02289<br>Ground<br>Water | 02458<br>Reclamation &<br>Development | 02472<br>Orphan Share |
|--|--------------------|------------------------------|-----------------------------|----------------------------|---------------------------|---------------------------------|--------------------------|---------------------------------------|-----------------------|
| <b>Beginning FY2007 Fund Balance</b>               | <b>\$219,561</b>   | <b>\$1,032,311</b>           | <b>\$89,346</b>             | <b>\$419,457</b>           | <b>\$716,170</b>          | <b>\$1,950,372</b>              | <b>\$0</b>               | <b>\$4,293,817</b>                    | <b>\$8,752,332</b>    |
| FY 2007 Revenues                                   | 47,000             | 500,000                      | 287,300                     | 1,363,265                  |                           | 2,571,500                       | 666,000                  | 5,857,740                             | 3,221,040             |
| FY 2007 Appropriations                             | (193,099)          |                              | (620,221)                   | (1,119,630)                | (374,079)                 | (1,394,999)                     | (666,000)                | (3,535,520)                           | (4,097,366)           |
| Reserved for Capital Appropriations                | 0                  | (1,532,311)                  |                             |                            |                           |                                 |                          |                                       |                       |
| Reserved for LT notes                              | 0                  |                              |                             |                            | 0                         | (114,423)                       |                          | (635,000)                             |                       |
| Projected Fund Balance Beginning FY 2008           | \$73,462           | \$0                          | (\$243,575)                 | \$663,092                  | \$342,091                 | \$3,012,450                     | \$0                      | \$5,981,037                           | \$7,876,006           |
| RIT Interest - Direct                              | 50,000             | 1,000,000                    | 389,740                     | 134,910                    | 500,000                   | 4,929,700                       | 600,000                  | 3,524,650                             |                       |
| RIGWA  |                    |                              |                             |                            |                           |                                 | 732,000                  | 476,601                               | 476,602               |
| Other Taxes  |                    |                              |                             |                            |                           |                                 |                          | 8,621,719                             | 6,621,719             |
| Agency Generated Revenues                          | 40,000             |                              | 18,000                      | 1,512,000                  | 430,000                   |                                 |                          |                                       |                       |
| Transfers  |                    |                              |                             |                            |                           |                                 |                          |                                       | (2,400,000)           |
| <b>Projected Fund Balance Beginning FY 2008</b>    | <b>\$163,462</b>   | <b>\$1,000,000</b>           | <b>\$164,165</b>            | <b>\$2,310,002</b>         | <b>\$1,272,091</b>        | <b>\$7,942,150</b>              | <b>\$1,332,000</b>       | <b>\$18,604,007</b>                   | <b>\$12,574,327</b>   |
| House Bills 6 and 7 Grants (Executive Recommended) |                    |                              |                             |                            |                           | 5,900,000                       |                          | 5,196,500                             |                       |
| MSU-Northern (Statutory)                           |                    |                              |                             |                            |                           | 480,000                         |                          |                                       |                       |
| UM-Bureau of Mines                                 |                    |                              |                             |                            |                           |                                 | 1,332,000                |                                       |                       |
| DNRC - Centralized Services                        |                    |                              |                             |                            |                           | 54,586                          |                          | 288,715                               |                       |
| DNRC - Conservation and Resource Devel. Division   |                    |                              |                             |                            |                           | 599,564                         |                          | 2,449,102                             |                       |
| DNRC-Water Resources Division                      |                    |                              |                             |                            | 625,000                   | 24,130                          |                          | 251,612                               |                       |
| DNRC-Flathead Basin Commission                     |                    |                              |                             |                            |                           | 13,682                          |                          | 172,709                               |                       |
| DNRC - Board of Oil & Gas HB 2                     | 194,382            |                              |                             |                            |                           |                                 |                          |                                       |                       |
| DNRC - Forestry Division                           |                    |                              |                             |                            |                           | 200,000                         |                          |                                       |                       |
| DNRC - Trust Lands                                 |                    |                              |                             |                            |                           |                                 |                          | 1,000,000                             |                       |
| DEQ-Central Management                             |                    |                              | 9,865                       |                            |                           |                                 |                          | 94,418                                |                       |
| DEQ-Planning, Prevention & Assistance              |                    |                              | 236,148                     |                            |                           |                                 |                          |                                       |                       |
| DEQ-Enforcement                                    |                    |                              |                             |                            |                           |                                 |                          | 8,810                                 |                       |
| DEQ-Remediation                                    |                    |                              | 58,050                      | 1,496,447                  |                           |                                 |                          |                                       | 4,135,026             |
| DEQ-Permitting & Compliance                        |                    |                              | 792,953                     |                            |                           |                                 |                          | 3,328,148                             |                       |
| FWP - HB 5 LRBP                                    |                    | 1,000,000                    |                             |                            |                           |                                 |                          |                                       |                       |
| Judiciary-Water Court                              |                    |                              |                             |                            |                           | 1,775,445                       |                          |                                       |                       |
| Library Commission-State Library Operations/NRIS   |                    |                              |                             |                            |                           |                                 |                          | 782,872                               |                       |
| HB 13 Pay Plan                                     |                    |                              |                             |                            |                           |                                 |                          |                                       |                       |
| <b>Appropriations</b>                              | <b>\$194,382</b>   | <b>\$1,000,000</b>           | <b>\$1,097,016</b>          | <b>\$1,496,447</b>         | <b>\$625,000</b>          | <b>\$9,047,407</b>              | <b>\$1,332,000</b>       | <b>\$13,572,886</b>                   | <b>\$4,135,026</b>    |
| <b>Ending Balance</b>                              | <b>(\$30,920)</b>  | <b>\$0</b>                   | <b>(\$932,851)</b>          | <b>\$813,555</b>           | <b>\$647,091</b>          | <b>(\$1,105,257)</b>            | <b>\$0</b>               | <b>\$5,031,121</b>                    | <b>\$8,439,301</b>    |

1 - EQPF Revenues include cost recovery. The actual biennial recovery has varied between \$1.0 to \$2.3 million.

**Figure 20**  
Proposed Legislation  
Resource Indemnity Funding

| Related Funds                                      | 02010             | 02022              | 02070              | 02162              | 02216              | 02289              | 02472               |                     |                     |
|--|-------------------|--------------------|--------------------|--------------------|--------------------|--------------------|---------------------|---------------------|---------------------|
|  | Oil & Gas         | Future Fisheries   | Hazardous Waste    | EQPF <sup>1</sup>  | Water Storage      | Ground Water       | Orphan Share        | Operations          | Projects            |
| <u>Beginning FY2007 Fund Balance</u>               | \$219,561         | \$1,032,311        | \$89,346           | \$419,457          | \$716,170          | \$0                | \$8,752,332         | \$0                 | \$0                 |
| FY 2007 Revenues                                   | 47,000            | 500,000            | 287,300            | 1,363,265          |                    | 666,000            | 3,221,040           | 0                   | 0                   |
| FY 2007 Appropriations                             | (193,099)         |                    | (620,221)          | (1,119,630)        | (374,079)          | (666,000)          | (4,097,366)         | 0                   | 0                   |
| Reserved for Capital Appropriations                | 0                 | (1,532,311)        |                    |                    |                    |                    |                     | 0                   | 0                   |
| Reserved for LT notes                              | 0                 |                    |                    |                    | 0                  |                    |                     | 0                   | 0                   |
| Projected Fund Balance Beginning FY 2008           | \$73,462          | \$0                | (\$243,575)        | \$663,092          | \$342,091          | \$0                | \$7,876,006         | \$4,496,743         | \$4,496,743         |
| RIT Interest - Direct                              | 50,000            | 1,000,000          | 389,740            | 134,910            | 500,000            | 600,000            |                     | 1,454,350           | 7,000,000           |
| RIGWA  |                   |                    | 238,301            | 238,301            |                    | 732,000            |                     |                     | 476,601             |
| Other Taxes  |                   |                    |                    |                    |                    |                    | 6,621,719           | 8,621,719           |                     |
| Agency Generated Revenues                          | 40,000            |                    | 18,000             | 1,512,000          | 430,000            |                    |                     |                     |                     |
| Transfers  |                   |                    |                    |                    | 125,000            |                    | (2,400,000)         |                     |                     |
| <u>Projected Fund Balance Beginning FY 2008</u>    | <u>\$163,462</u>  | <u>\$1,000,000</u> | <u>\$402,466</u>   | <u>\$2,548,303</u> | <u>\$1,397,091</u> | <u>\$1,332,000</u> | <u>\$12,097,725</u> | <u>\$14,572,812</u> | <u>\$11,973,344</u> |
| House Bills 6 and 7 Grants (Executive Recommended) |                   |                    |                    |                    |                    |                    |                     |                     | 11,096,500          |
| UM-Bureau of Mines                                 |                   |                    |                    |                    |                    | 1,332,000          |                     |                     |                     |
| DNRC - Centralized Services                        |                   |                    |                    |                    |                    |                    |                     | 343,301             |                     |
| DNRC - Conservation and Resource Devel. Division   |                   |                    |                    |                    |                    |                    |                     | 3,048,666           |                     |
| DNRC-Water Resources Division                      |                   |                    |                    |                    | 625,000            |                    |                     | 275,742             |                     |
| DNRC-Flathead Basin Commission                     |                   |                    |                    |                    |                    |                    |                     | 186,391             |                     |
| DNRC - Board of Oil & Gas HB 2                     | 194,382           |                    |                    |                    |                    |                    |                     |                     |                     |
| DNRC - Forestry Division                           |                   |                    |                    |                    |                    |                    |                     | 200,000             |                     |
| DNRC - Trust Lands                                 |                   |                    |                    |                    |                    |                    |                     | 1,000,000           |                     |
| DEQ-Central Management                             |                   |                    | 9,865              |                    |                    |                    |                     | 94,418              |                     |
| DEQ-Planning, Prevention & Assistance              |                   |                    | 236,148            |                    |                    |                    |                     |                     |                     |
| DEQ-Enforcement                                    |                   |                    |                    |                    |                    |                    |                     | 8,810               |                     |
| DEQ-Remediation                                    |                   |                    | 58,050             | 1,496,447          |                    |                    | 4,135,026           |                     |                     |
| DEQ-Permitting & Compliance                        |                   |                    | 792,953            |                    |                    |                    |                     | 3,328,148           |                     |
| FWP - HB 5 LRBP                                    |                   | 1,000,000          |                    |                    |                    |                    |                     |                     |                     |
| Judiciary-Water Court                              |                   |                    |                    |                    |                    |                    |                     | 1,775,445           |                     |
| Library Commission-State Library Operations/NRIS   |                   |                    |                    |                    |                    |                    |                     | 782,872             |                     |
| HB 13 Pay Plan                                     |                   |                    |                    |                    |                    |                    |                     |                     |                     |
| <u>Appropriations</u>                              | <u>194,382</u>    | <u>1,000,000</u>   | <u>1,097,016</u>   | <u>1,496,447</u>   | <u>625,000</u>     | <u>1,332,000</u>   | <u>4,135,026</u>    | <u>11,043,793</u>   | <u>11,096,500</u>   |
| Ending Balance                                     | <u>(\$30,920)</u> | <u>\$0</u>         | <u>(\$694,550)</u> | <u>\$1,051,856</u> | <u>\$772,091</u>   | <u>\$0</u>         | <u>\$7,962,699</u>  | <u>\$3,529,019</u>  | <u>\$876,844</u>    |

1 - EQPF Revenues include cost recovery. The actual biennial recovery has varied between \$1.0 to \$2.3 million.

## LFD ISSUE

### Fund Balance Shortfalls

Three funds are projected to have a negative ending fund balance at the end of FY 2009 as per current law and the proposed legislation. These funds include the oil and gas fund, the renewable resources fund, and the hazardous waste fund.

The oil and gas mitigation fund can utilize reclamation bonds to raise the necessary revenue to plug abandoned wells. The negative balance in cash could be made up through these bonds.

The renewable resource fund is over-appropriated under current law. The legislature has two options: 1) reduce the appropriation authority from the fund; or 2) change the manner in which RIT revenues are distributed to this fund. The second option is addressed in the proposed legislation (LC 0147).

The hazardous waste fund appears to be over-appropriated. However, the issue is the manner in which revenue is deposited to the fund. The hazardous waste fund by statute (75-10-621, MCA) is to receive proceeds and interest on bonds or notes issued for state match to the Superfund program. However, those revenues are not deposited and expended from this fund. The Superfund bond proceeds and subsequent expenses are held in a fund specific to the series released. The legislature has the option of addressing legislation to clarify the disposition of the interest and proceeds, and the hazardous waste account could receive additional revenues and potentially eliminate the negative ending fund balance.